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T. C. Memo. 1986-126

UNITED STATES TAX COURT

ROBERT R. AND DEBORAH L. POYER, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 33971-84. Filed March 27, 1986.

Petitioner, whose principal income in 1982 was from wages, joined the Virginia Patriots in 1983. At the suggestion of a representative of the Virginia Patriots, petitioner filed Forms W-4 claiming 14 exemptions and also filed an amended return for 1982 claiming a deduction for "cost of goods sold" in an amount that completely eliminated his taxable income. He requested and received a refund of the taxes paid for 1982. In his notice of deficiency respondent disallowed the deduction for "cost of goods sold" and determined an addition to tax for fraud.

Held: Petitioner failed to prove that he was entitled to the deduction for "cost of goods sold."

Held, further: The underpayment of tax shown on petitioner's amended return for 1982 was due to fraud.

Robert R. and Deborah L. Poyer, pro se.

John C. McDougal, for the respondent.

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MEMORANDUM FINDINGS OF FACT AND OPINION

DRENNEN, Judge: Respondent determined a deficiency in petitioners' 1982 Federal income tax of $3,506.00, an addition to tax pursuant to section 6653(b)(1)[1/] of $1,753.00, and an addition to tax in an unspecified amount under section 6653(b)(2).[2/]

The issues for our decision are 1) whether petitioners are entitled to a "cost of goods sold" deduction in 1982 representing the value of petitioner's [3/] services to his employer, and 2) whether any part of petitioners' underpayment was due to fraud.

FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly. The stipulation of facts and attached exhibits are incorporated by this reference.

Petitioners Robert R. and Deborah L. Poyer are husband and wife and resided in Newport News, Virginia at the time they filed their petition in this case. They filed a timely joint Federal income tax return for the taxable year 1982 with the Internal Revenue Service Center in Memphis, Tennessee. On that return, prepared by H&R Block, petitioners reported wages of $29,828.00 from petitioner's employment, excess itemized deductions of

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1/ All section references are to the Internal Revenue Code of 1954, as amended, and in effect during the taxable year at issue.

2/ The amount of the section 6653(b)(2) addition to tax will be determined at the time of assessment.

3/ All references to petitioner refer to Robert R. Poyer. Deborah L. Poyer is a petitioner in this case only because she filed a joint return with her husband.

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$1,893.00 and a tax liability of $1,506.00. The wages earned by petitioner were for services rendered to the Department of the Army, Jarrell's Truck Plaza, and Eastates Petroleum Co., Inc.

In July 1983, petitioner attended a meeting of an organization known as the Virginia Patriots. The Virginia Patriots was a self-proclaimed constitutional study group which viewed the actions of the Internal Revenue Service (IRS), as illegal. The Virginia Patriots adopted the theory that wages are not taxable as income but are received in an equal exchange for one's services.

Roy Sheffler (Sheffler), a Special Agent for the IRS, was assigned to conduct an undercover investigation of the Virginia Patriots. Sheffler attended four meetings of the Newport News Chapter of the Virginia Patriots in August and September of 1983. He joined the organization under the name of Bill Bryce.

At Virginia Patriots' meetings, members were advised on how to file Forms W-4 to prevent any withholding from their paychecks. Members were told at first to write "exempt" on their Forms W-4. When the IRS began disallowing these exempt Forms W-4, members were advised to claim 14 exemptions. This amount of exemptions was chosen because it was viewed as sufficient to prevent all withholding from taxes. Members were also advised on ways to avoid or delay assessment or collection of taxes. In addition, a member could bring copies of their prior years' returns to the meetings and amended returns for open years would be prepared by one of the Virginia Patriots' leaders so that all

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the Federal income tax paid by a member would be refunded. A legal defense fund was established by the Virginia Patriots to assist members who were audited by the IRS. Members were also advised to place their assets in someone else's name so that they would have no assets to be seized by the IRS, and to not use bank accounts so that the IRS could not reconstruct their income from such accounts.

Sheffler visited the residence of James DuBose, Sr. (DuBose), one of the leaders of the Virginia Patriots. Sheffler was referred to DuBose by another member of the Virginia Patriots for assistance in amending his 1982 return. DuBose prepared an amended return, Form 1040X, for Sheffler that indicated that Sheffler had zero tax liability in 1982. DuBose worked through the amended return in reverse order to arrive at an adjustment to income. The adjustment to income utilized by DuBose on Sheffler's return was supported by a Schedule C for a non-existent business. The adjustment was based upon a deduction for the "cost of goods sold." To explain why the return was being amended, DuBose wrote on page 2 of the Form 1040X that "the changes on lines 1, 3, and 5 are the result of business expenses not previously reported."

DuBose then told Sheffler to copy the return in his own handwriting before mailing it to the IRS. DuBose prepared two amended returns for Sheffler and told him to mail the returns in separate envelopes, at least a week apart to lessen the possibility that the same person would receive both returns.

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On July 23, 1983, petitioner joined the Virginia Patriots. He paid a membership fee of $100.00 and later paid an additional fee of $60.00. On July 25, 1983, petitioner filed a Form W-4 with his employer claiming 14 exemptions. Prior to this time, petitioner had claimed two exemptions. The Form W-4 was signed by petitioner under penalty of perjury. Petitioner had attended Virginia Patriots meetings where the filing of false Form W-4s had been discussed. He was advised to claim 14 exemptions by a member of the Virginia Patriots.

Petitioner gave a copy of his 1982 return to a Mr. Sugarman, president of the Virginia Patriots, to have an amended return prepared. Shortly thereafter he received the amended return, copied it in his own handwriting, and filed it. The amended return was very similar to the one prepared by DuBose for Sheffler. The return contained a Schedule C with a $19,083.00 "cost of goods sold" deduction. This deduction was sufficient to reduce petitioner's tax liability to zero. On page 2 of the form petitioner also wrote, as DuBose had on Sheffler's return, that the "changes in lines 1, 3, and 5 are the result of business expenses not previously reported." Sample returns bearing petitioner's name, along with other sample amended returns, were seized by the IRS in a search, pursuant to a warrant of the Virginia Patriots' offices.

At trial petitioner testified that in 1982 he sold a gas additive called "Mixigo." He purchased "Mixigo" from a distributor for $95.00 a case and sold it for $180.00. He paid

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his wife $110.00 a week for helping him. He stated that he also incurred travel expenses in selling "Mixigo." He did not include any income or expenses from the sale of "Mixigo" on his 1982 return. The Form 1040X prepared for petitioner by the Virginia Patriots did not reflect any adjustment based upon petitioner's sale of "Mixigo." Petitioner agreed with respondent that any losses he incurred from the sale of "Mixigo" were not sufficient to reduce his tax liability to zero.

Based upon the amended return filed by petitioners, the IRS issued a refund to petitioners in the amount of $3,506.00, plus interest. On a subsequent audit of petitioners' returns, respondent disallowed the deduction for "cost of goods sold" claimed on the amended returns, which resulted in the deficiency in tax involved herein.

OPINION

Petitioners contend that they should be allowed a "cost of goods sold" deduction for the taxable year 1982. They appear to base their claim upon petitioner's sales of a gas additive called "Mixigo." Petitioners also contend, on brief, that petitioner "had no 'income', only compensation for labor, as described by the courts." Petitioners further contend that they are not liable for the addition to tax for fraud because they were merely following IRS procedures in filing a claim for refund, and that the filing of a Form W-4 is not mandatory.

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Respondent contends that petitioners' "cost of goods sold" deduction should be disallowed because the real basis for their claim for a refund was that wages are not taxable income. In addition, respondent contends that his addition to tax for fraud should be upheld because petitioners falsely and fraudulently concealed the true basis for their claim for refund and then cashed the falsely obtained refund check, and because petitioner filed false and fraudulent Forms W-4.

It is clear that petitioner's compensation in the form of wages, is taxable income. Rowlee v. Commissioner, 80 T.C. 1111, 1119-22 (1983); Section 61(a). Petitioners, in seeking a "cost of goods sold" deduction, appear to be arguing that they should be allowed a deduction for the value, or cost, of their labor. According to them, the value of their labor is equal to the wages they earned resulting in their having no profit and a zero tax liability. Petitioner argues that compensation for labor cannot be considered "profit" and hence cannot be taxable income. Taxable income is not limited to "profit" as that term is generally understood. The Sixteenth Amendment to the Constitution authorizes Congress to tax income "from whatever source derived" and section 61 of the Code defines gross income as "income from whatever source derived *** including compensation for services." Arguments such as these have also been rejected by this Court because they fail to recognize that the "cost of goods sold" concept involves property or physical goods, not the cost of maintaining people. United States v.

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Gilmore, 372 U.S. 39, 43 (1963); Reading v. Commissioner, 70 T.C. 730, 733 (1978), affd. per curiam 614 F.2d 159 (8th Cir. 1980). Petitioner cannot prevail with this argument.

At trial petitioner also argued that he was in the business of selling a gas additive called "Mixigo" and should therefore be allowed a deduction for the expenses he incurred in connection with his sales of "Mixigo." However, petitioner also stated that these expenses were not taken into consideration in preparing his Form 1040X for 1982. Moreover, petitioners have not offered any evidence, except petitioner's own self-serving assertions, that such a business existed, that such expenses were actually incurred, or that the expenses were incurred in 1982, the taxable year at issue. Petitioner has failed to prove that he incurred the expenses he is now claiming as business deductions.

Deductions are a matter of legislative grace. New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440 (1934). An important corollary to this principle is that it is the taxpayer's burden to establish that he is entitled to the deductions claimed. Welch v. Helvering, 290 U.S. 111, 115 (1933); Rule 142(a).[4/] Accordingly, we find that petitioners have failed to carry their burden of proof in regard to the deduction claimed and we therefore sustain respondent's determination.

With respect to the fraud issue, respondent has the burden of proving, by clear and convincing evidence, that there was an underpayment of tax and that some part of the underpayment was

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4/ All rules references are to the Tax Court Rules of Practice and Procedure.

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due to fraud with the intent to evade tax. Section 7454(a); Rule 142(b). This burden is met if it is shown that the taxpayer intended to conceal, mislead, or otherwise prevent the collection of such taxes. Spies v. United States, 317 U.S. 492, 499 (1943); United States v. Conforte, 624 F.2d 869 (9th Cir. 1980). The existence of fraud is a fact which must be determined on the basis of all facts and circumstances. Estate of Pittard v. Commissioner, 69 T.C. 391 (1977). Since direct proof of a taxpayer's fraud is rarely available, circumstantial evidence may be utilized to prove fraud. Rowlee v. Commissioner, supra. The taxpayer's entire course of conduct may establish the requisite fraudulent intent. Stone v. Commissioner, 56 T.C. 213, 223-224 (1971); Otuski v. Commissioner, 53 T.C. 96, 105-106 (1969).

In this case there is clear and convincing evidence that petitioners acted with fraudulent intent. In fact, it is clear that petitioner's actions were motivated by a purpose to evade the payment of tax he knew to be owing. As noted previously, shortly after petitioner joined the Virginia Patriots, he filed a false Form W-4 with his employer claiming 14 exemptions. Petitioner had learned at a Virginia Patriots' meeting that this tactic should help one avoid paying taxes. Prior to that time, petitioner had claimed two exemptions. Filing of false Forms W-4 has been held to be indicative of fraud. Hebrank v. Commissioner, 81 T.C. 640, 642 (1983); Habersham-Bey v. Commissioner, 78 T.C. 304, 313 (1982).

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Furthermore, on his amended return petitioner claimed a deduction in the amount of $19,083.00 for "cost of goods sold" which, so far as we can determine, was non-existent.5/ The purpose of this claim appears to have been to offset the income from wages reported on petitioner's original return in an effort to fraudulently recover the taxes he had paid with his original return. At the trial petitioner blatantly admitted that he thought the refund he received was great because he had paid it in and was entitled to get it back.

5/ Petitioner's testimony at the trial is hard to rationalize and is further evidence that his principal objective in filing the amended return and the false Forms W-4 was to avoid payment of tax. The filing of the false Forms W-4 was admittedly to avoid having taxes withheld from his wages. However, these were not filed until 1983 and would not accomplish this purpose for 1982. Only five exemptions were claimed on the amended 1982 return, which is the year before us. So in order to get a refund of the taxes he had paid for 1982, petitioner had to claim a deduction to offset the income from wages that he had reported on his original return. He did this by claiming a deduction for "cost of goods sold" in the amount of $19,083.00 on his amended return for 1982. When asked at trial what this deduction was attributable to, petitioner said he did not know, but it was definitely not attributable to his "Mixigo" business, which he said he was holding in reserve. Petitioner also denies that the deduction was based on his cost for the wages that he had received, despite the fact the Schedule C-1, Cost of Goods Sold, attached to this amended return lists only $19,083.00 as "Cost of Labor," and also the fact that the Virginia Patriots and petitioner himself espoused the theory that wages are not income. So petitioner has left himself with no basis for the deduction here involved. Our analysis of this is that petitioner was willing to claim anything anyone suggested to him that would result in a refund of the taxes he had paid for 1982.

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Respondent has carried his burden of proof on the fraud issue.

Petitioner is also liable for the addition to tax imposed by section 6653(b)(2) computed on the deficiency determined in the notice of deficiency in the amount of $3,506.00.

Decision will be entered for respondent.

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T. C. Memo. 1986-127

UNITED STATES TAX COURT

MARTIN H. FISHMAN AND HARRIET FISHMAN, ET AL.,[1] Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 3916-81,
771-82,
772-82,
773-82.

Filed March 31, 1986.

Martin H. Fishman, pro se.

Arthur W. Friedman, for the petitioners in docket Nos. 771-82, 772-82, and 773-82.

Janet A. Engel, for the respondent.

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[1] Cases of the following petitioners are consolidated herewith: Seymour N. Logan Insurance Trust - Trust B, Milton I. Shadur, Trustee, docket No. 771-82; Renee Logan, docket No. 772-82; and Harold Halpern, docket No. 773-82.

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MEMORANDUM FINDINGS OF FACT AND OPINION

TANNENWALD, Judge: Respondent determined the following deficiencies in petitioners' Federal income taxes:

Docket No.	Taxable Year	Deficiency
3916-81	1976	$ 3,498
	1977	1,088
771-82	1977	20,141
	1978	4,463
772-82	1977	30,746
	1978	7,024
773-82	1977	454

After concessions, the issues for decision are (1) whether costs incurred by the partnership prior to November 1, 1977 were for the production of income, or for the maintenance, management or conservation of property held for the production of income, and in turn are deductible as expenses under section 212(1)[2] or 212(2), or, alternatively, are deductible under section 162(a), and (2) whether the "professional" fees deducted by the partnership in 1976 are nondeductible partnership organizational expenses under section 709(a).

FINDINGS OF FACTS

Some of the facts have been stipulated and are so found. This reference incorporates the stipulations of facts and attached exhibits.

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2 Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue, and all Rule references are to the Rules of Practice and Procedure of this Court.

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Petitioners Martin Fishman and Harriet Fishman resided in Lincolnwood, Illinois at the time they filed their petition in this case. They timely filed joint Federal income tax returns for the years 1976 and 1977. The trustee of petitioner Seymour N. Logan Insurance Trust - Trust B (the "trust"), Milton I. Shadur, resided in Glencoe, Illinois at the time he filed his petition. Timely Federal fiduciary income tax returns (Forms 1041) were filed for the trust for the taxable years ending June 30, 1977 and June 30, 1978, with the Internal Revenue Service Center, Kansas City, Missouri. Petitioner Renee Logan resided in Chicago, Illinois at the time she filed her petition. She timely filed Federal income tax returns for the years 1977 and 1978 with the Internal Revenue Service Center, Kansas City, Missouri. Petitioner Harold Halpern resided in Chicago, Illinois at the time he filed his petition. He timely filed a Federal income tax return for the year 1977 with the Internal Revenue Service Center, Kansas City, Missouri.

Pursuant to a partnership agreement (the "agreement"), entered into by petitioners Harold Halpern and Renee Logan and dated August 21, 1975, the Johnstowne Centre Partnership (the "partnership") was created. The partnership was formed for "the limited purposes of leasing, constructing, developing, and otherwise dealing with real and personal property in connection

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with the development of" a multi-unit commercial project (shopping center) on property in Champaign, Illinois (the "Project").

On September 19, 1975, petitioner Halpern, on behalf of the partnership, entered into an agreement by which the partnership obtained an option to enter into a 50 year ground lease of the property intended to be developed.

On February 15, 1976, the partnership entered into a trust agreement with the American National Bank and Trust Company of Chicago by which the partnership, the trust's sole beneficiary, empowered the trustee-bank to acquire a leasehold interest on behalf of the partnership in the property on which the Project was to be developed. On July 13, 1976, the partnership exercised the aforesaid option and on September 30, 1976, the trustee-bank and the owner entered into a 50 year lease on the property for a monthly rental of $2,500.

In August 1976, the partnership received a permanent mortgage loan standby commitment in the amount of $900,000 from Mutual Home Savings & Loan. The partnership paid a $9,000 fee for the commitment and $9,000 to the firm of Salk, Ward and Salk for their services in negotiating the commitment. In November 1976, the partnership received a $900,000 construction mortgage loan commitment from Busey First National Bank and paid it a $9,000 commitment fee, one-half of which was paid in 1976 and the balance in 1977. On December 31, 1976, the partnership entered

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into a construction contract with Turnkey, Inc., for the construction of the Project, calling for the completion of the Project by the fall of 1977.

On February 25, 1976, the partnership entered into its first lease with a commercial tenant. Six subsequent leases were entered into during 1976. During 1977, five additional leases were entered into, all prior to November 1. Security deposits were received by the partnership with respect to every lease. When ground breaking for the shopping center took place in March 1977, approximately 1/3 of the space in the shopping center had been leased to commercial tenants.

On March 23, 1977, the ground lease was amended to require the trustee-bank to provide an irrevocable letter of credit to be issued by First National Bank of Chicago. The letter of credit authorized the lessor to draw on the partnership account in the amount of $500,000 in the event, among other things, that the Project had not been completed in basic accordance with the construction contract entered into by the partnership and Turnkey, Inc. The letter of credit was in lieu of a performance bond initially called for in the lease that the contractor had been unable to secure. The partnership paid a $4,930.55 fee to First National Bank of Chicago to obtain the letter of credit.

In September 1977, the partnership advised its prospective tenants that their space would be available on September 30, 1977, and that rent would not be due until November 1, 1977.

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This schedule was adhered to. The partnership's Federal income tax return for 1977 states that it acquired the shopping center on November 1, 1977.

In addition to the rents and fees already mentioned, the partnership incurred the following expenses during the taxable year ending December 31, 1976, and during the first ten months of the taxable year ending December 31, 1977:[3]

	12/31/76	10/31/77
Trust Fee	$ 166.00	$ 95.00
Business Promotion and Organization	1,798.00	0
Advertising	391.00	0
Professional Fees	7,930.00	0
Miscellaneous	655.00	20.19
Office Expense	293.00	0
Insurance	148.00	0
Consulting	1,340.00	0
Survey	666.00	0
Accounting and Legal	0	350.00
Travel and Auto	0	1,415.33
Telephone and Office	599.00	1,169.66

OPINION

Initially, we observe that the focus of this case is a narrow one. Respondent's disallowances are grounded for the most part on the so-called "preopening expense doctrine" which he claims is applicable both under section 162(a)[4] and section 212.

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[3] With respect to the 1977 taxable year, it appears from a comparison of the partnership return and the statutory notices of deficiency that respondent has only disallowed those expenses that were incurred prior to the opening of the shopping center on November 1, 1977.

[4] Section 162(a) provides that a taxpayer may deduct "all the ordinary and necessary expenses paid or incurred during the

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He urges us to overrule Johnsen v. Commissioner, 83 T.C. 103 (1984) and Hoopengarner v. Commissioner, 80 T.C. 538 (1983), affd. without published opinion 745 F.2d 66 (9th Cir. 1984). In the event we do not accede to his urging, with the exception of the brokerage fee and "professional" fees, see infra pp. 10-13, respondent does not argue that the disallowed items are otherwise not deductible.[5]

In Hoopengarner v. Commissioner, supra, taxpayer acquired a leasehold interest in a parcel of undeveloped land and proceeded to construct and operate an office building on the leased premises. We held that, pursuant to section 212(2), taxpayer could deduct rental payments under the ground lease, even though such payments were incurred before the building was completed and occupied and were thus nondeductible as "preopening expenses" under section 162. In so holding, we concluded that the

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(footnote continued from previous page)
taxable year in carrying on a trade or business." It is well settled that section 162(a) operates to deny a taxpayer deductions for "preopening expenses" of the type here in issue which are incurred prior to the time that a business begins to function as a going concern and performs those activities for which it was organized. Richmond Television Corp. v. United States, 345 F.2d 901, 907 (4th Cir. 1965), vacated and remanded on other issues 382 U.S. 68 (1965); Johnsen v. Commisioner, 83 T.C. 103, 114 (1984); Hoopengarner v. Commissioner, 80 T.C. 538, 540 (1983), affd. without published opinion 745 F.2d 66 (9th Cir. 1984); Goodwin v. Commissioner, 75 T.C. 424, 435 (1980), affd. without published opinion 691 F.2d 490 (3d Cir. 1982); Madison Gas & Electric Co. v. Commissioner, 72 T.C. 521, 566-567 (1979), affd. 633 F.2d 512, 517 (7th Cir. 1980).

5 With respect to the commitment fees, respondent expressly concedes their deductibility, see infra note 7.

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"preopening expense doctrine" did not apply to section 212 since such section has no "trade or business" requirement. 80 T.C. at 543.

In Johnsen v. Commissioner, supra, a partnership acquired a leasehold interest in a piece of property on which it constructed and operated a project. In extending our holding in Hoopengarner v. Commissioner, supra, we held that, pursuant to section 212(1) or 212(2), the taxpayer could deduct his share of construction loan commitment, permanent loan commitment[6] and management and guarantee fees claimed by the partnership, even though these expenses were incurred prior to the opening of the project. 83 T.C. at 119.[7] In so holding, we rejected respondent's contention that Hoopengarner was incorrectly decided and should be overruled. We made it clear that, at the time Hoopengarner was before this Court, respondent's arguments had been thoroughly

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6 We disallowed a portion of the permanent loan commitment fee because we deemed it to be excessive and not reasonable in amount, and thus not ordinary and necessary under section 212. Johnsen v. Commissioner, supra at 122-125. There is no issue as to reasonableness in the instant case.

7 As in Johnsen, respondent has conceded herein that, to the extent that the commitment fees are otherwise deductible under sec. 212, he will follow Rev. Rul. 56-136, 1956-1 C.B. 92, revoked prospectively only, Rev. Rul. 81-160, 1981-1 C.B. 312, and will not contend that the commitment fees are capital expenditures. While we thus have no occasion to look behind respondent's concession, we note that respondent's position on this question was, to say the least, murky prior to the issuance of Rev. Rul. 81-160. See Duffy v. United States, 231 Ct. Cl. 679, 690 F.2d 889, 893-894 (1982); Johnsen v. Commissioner, supra at 121 n.8; Francis v. Commissioner, T.C. Memo. 1977-170; Rev. Rul. 75-172, 1975-1 C.B. 145.

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considered and rejected and that our position had not changed. 83 T.C. at 117. Since our decision in Johnsen, the Ninth Circuit Court of Appeals has affirmed our decision in Hoopengarner (745 F.2d 66 (9th Cir. 1984)).[8] We again reject respondent's assertion that we incorrectly decided Hoopengarner and Johnsen.[9]

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We note that the Eighth Circuit Court of Appeals has recently declined to follow the Hoopengarner path. See Aboussie v. Commissioner, 779 F.2d 424, 428-429 n.6 (8th Cir. 1985).

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Respondent asserts that we failed to consider his argument in Johnsen that the taxpayer had not shown that he had a possessory or proprietary interest in any income producing property, and thus did not qualify for a section 212 deduction. Although we dismissed this argument in Johnsen as having been untimely raised, we made it clear in Hoopengarner v. Commissioner, supra at 541, that while:

> [w]e are conscious that there is a requirement under section 212 that the taxpayer have a proprietary or possessory interest in the income producing property * * * [w]e have found that petitioner met this requirement by virtue of his ownership of the lease. * * * [Emphasis added. Citations omitted.]

To the extent that respondent is relying on the fact that the trustee-bank and not the partnership was the record lessee to distinguish the instant situation from that which existed in Johnsen and Hoopengarner, we think he is grasping at a straw. Any such distinction is a distinction without a difference since the trustee-bank was clearly the agent of the partnership and performed no function other than that of the nominal lessee. Cf. Derr v. Commissioner, 77 T.C. 708, 724-725 n.11 (1981); People v. Chicago Title & Trust Co., 75 Ill. 2d 479, 389 N.E.2d 540, 545 (1979).

We note that section 195, which was added to the Internal Revenue Code as part of the Miscellaneous Revenue Act of 1980, Pub. L. 96-605, 94 Stat. 3521 and was amended under the Deficit Reduction Act of 1984, Pub. L. 98-369, 98 Stat. 494, disallows current deductions for start-up expenditures, but does allow the taxpayer to elect to amortize these expenditures for a period of not less than 60 months. Section 195, as amended, however, is

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Accordingly, we hold that with the exception of the brokerage and "professional" fees, discussed below, petitioners are entitled to all their claimed deductions.[10]

Respondent's concession as to the commitment fees, see supra note 7, expressly did not cover the $9,000 brokerage fee paid to secure the permanent loan commitment. Thus, we must address the capital expenditure versus deductible expense issue which is involved in determining the correctness of respondent's disallowance of the current deductibility in full of this item. Nothing in either Johnsen v. Commissioner, supra, or Hoopengarner v. Commissioner, supra, affects our disposition of this issue; those cases involved the current deductibility of annual expense items or the amortizable portion of certain expenditures under the "preopening expense doctrine." It is well-established that a brokerage fee in respect of a loan commitment is a capital expenditure that must be amortized over the life of the loan. Duffy v. United States, 231 Ct. Cl. 679, 690 F.2d 889, 896 (1982); Lay v. Commissioner, 69 T.C. 421, 439 (1977); Longview Hilton Hotel Co. v. Commissioner, 9 T.C. 180, 182 (1947); cf.

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only applicable to taxable years beginning after June 30, 1984.

[10] In light of our allowance of petitioners' deductions under section 212, we find it unnecessary to address petitioners' alternative argument that these expenses are deductible under section 162. We do note, however, that for the same reasons to be outlined below, petitioners' claimed deductions for brokerage and "professional" fees would be similarly disallowed under a section 162 analysis.

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Rev. Rul. 57-400, 1957-2 C.B. 520. Consequently, respondent's disallowance of this item as a currently deductible expense is sustained.

Similarly, to the extent that we find that the $7,930 in "professional" fees deducted by the partnership in 1976 qualified as a partnership organizational expense under section 709(a), they were properly disallowed, because section 709(a) provides that:

> [e]xcept as provided in subsection (b), no deduction shall be allowed under this chapter to the partnership or to any partner for any amounts paid or incurred to organize a partnership or to promote the sale (or to sell) an interest in such partnership.[11]

Moreover, section 1.709-2(a), Income Tax Regs., defines "[l]egal fees for services incident to the organization of the partnership, such as negotiation and preparation of a partnership agreement" as an example of an organizational expense within the meaning of section 709.

To sustain their claimed deduction with respect to the "professional" fees, petitioners rely on the oral testimony of Mr. Fishman at trial that the bulk of these legal expenses were incurred in connection with the financing activities of the partnership. Respondent asks that we disallow the entire expense

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Section 709(b) provides for the amortization of specified organizational expenses over a period of not less than 60 months, if the partnership so elects, effective with respect to taxable years beginning after December 31, 1976. The partnership made no such election.

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as a nondeductible organizational expense because petitioners have failed to meet their burden of proof (see Rule 142(a); Welch v. Helvering, 290 U.S. 111 (1933)) that only a portion of these expenses were nondeductible. We agree with respondent.

We are satisfied that an unspecified portion of the "professional" fees were section 709 expenses. In order for this Court to make a reasonable estimate as to what portion of these fees are deductible expenses, see Cohan v. Commissioner, 39 F.2d 540 (2d Cir. 1930), there must be sufficient evidence that at least the amount allowed in such an estimate was in fact incurred for deductible legal fees. Williams v. United States, 245 F.2d 559, 560 (5th Cir. 1957); Johnsen v. Commissioner, supra at 127. Although we recognize that it is improbable that the full $7,930 in legal fees were incurred solely to form the partnership, Mr. Fishman's general testimony furnishes us with no basis for determining how much time and effort was spent between the two categories of activities and there is no other evidence in the record on this score. Thus, respondent's disallowance of the entire deduction for this item is sustained. See Merians v. Commissioner, 60 T.C. 187, 189-190 (1973).

To reflect the foregoing,

Decisions will be entered under Rule 155.

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UNITED STATES TAX COURT

JEROME S. MOSS AND SANDRA MOSS, ET AL.,[1] Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 5571-82, 5572-82, 5573-82. Filed March 31, 1986.

Petitioners are the owners of a hotel through their respective partnership interests. The hotel was leased to another partnership who, in turn, subleased the property for management purposes. Prior to the taxable year in issue, the sublessee of the hotel and its guarantor suffered financial difficulties. Substantial repairs, maintenance and capital improvements were not performed on the hotel for several years. The guarantor was released from its obligations and petitioners entered into a new agreement with respect to the hotel's management.

Incorporated directly within the new management agreement and set forth as a condition to its execution was the establishment of a $2 million program of capital improvements and refurbishings, including repairs and maintenance. The actual work performed encompassed the complete remodeling of a substantial portion of the hotel, including a majority of the guest rooms as well as public areas, such as the hotel lobby, ballrooms, meeting rooms, restaurants and bar. Petitioners deducted a total of approximately $400,000 as

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[1] Cases of the following petitioners are consolidated herewith: Sharon M. Alesia, docket No. 5572-82, and Herb Alpert and Lani Alpert, docket No. 5573-82.

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expenses attributable to repairs and maintenance ($270,268 for the taxable year in issue), and amortized approximately $1,500,000 as capital expenditures.

Held, respondent properly denied petitioners' deduction of expenses attributable to hotel repairs and maintenance as ordinary and necessary business expenses. The expenditures incurred for repairs must be amortized as incidental to a plan of capital improvements of the hotel property.

John C. Fossum and Dana E. Miles, for the petitioners.

Pamela R. Piland, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

STERRETT, Chief Judge: Respondent determined deficiencies in petitioners' Federal income taxes for the taxable year ended December 31, 1976 in these consolidated cases by separate notices of deficiency, each dated December 24, 1981, as follows:

Docket No.	Petitioner(s)	Deficiency
5571-82	Jerome S. Moss and Sandra Moss	$60,725
5572-82	Sharon M. Alesia	27,785
5573-82	Herb Alpert and Lani Alpert	26,687

After concessions,[2] the sole issue for decision is whether certain expenditures incurred in the 1976 taxable year totaling $270,268 are deductible under section 162[3] as ordinary and

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2 Petitioner Sharon M. Alesia does not contest the two other adjustments determined by respondent in the notice of deficiency issued to her based on (1) the disallowance of a depreciation deduction in the amount of $5,570 and (2) the decrease of erroneously included income in the amount of $7,422.

3 Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect during the taxable year in question, and all Rule references are to the Tax Court Rules of Practice and Procedure.

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necessary repairs or must be depreciated under section 263 as capital expenditures pursuant to a general plan of capital improvements.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation of facts, together with the exhibits attached thereto, are incorporated herein by this reference.

Petitioners filed timely Federal income tax returns for the 1976 taxable year with the Internal Revenue Service Center in Fresno, California. Petitioners Jerome S. and Sandra Moss and Herb and Lani Alpert resided in Los Angeles, California, and petitioner Sharon M. Alesia resided in Beverly Hills, California at the time they filed their petitions in these consolidated cases. Petitioners utilized the cash receipts and disbursements method of accounting to report their income for the 1976 taxable year.

On January 1, 1975, Almo Hotel Company, Ltd. (Almo), a California limited partnership, was formed. Petitioners' respective interests in Almo's profits and losses were as follows:

Jerome S. Moss	general partner	50%
Sharon M. Alesia	limited partner	25%
Herb Alpert	general partner[4]	25%

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[4] In their requested findings of fact, petitioners proposed that Herb Alpert was a limited partner and respondent proposed that he was a general partner, but neither party objected to the (footnote continued)

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David A. Alpert, brother of petitioner Herb Alpert, also was a general partner of Almo. Although he did not have any interest in partnership profits or losses, the Almo partnership agreement provided that David A. Alpert had full authority to bind the partnership pursuant to contract.

During the taxable year at issue, Almo was the sole fee owner of a hotel (the hotel) located at 6225 West Century Boulevard, Los Angeles, California, near the Los Angeles International Airport. Prior to Almo's formation, the hotel was owned solely by Almo Enterprises, a California limited partnership, which had purchased the hotel in 1967 at a cost of $12,600,000. The partners of Almo Enterprises were petitioners Jerome S. Moss, Sharon M. Alesia, and Herb Alpert, and their respective partnership interests were identical to their partnership interests in Almo.

The hotel was constructed in 1963 and since it opened has operated as a major business hotel in the Los Angeles International Airport area. The hotel is a 13-story, reinforced, concrete building containing approximately 620 guest rooms, 2 large restaurants, 2 cocktail lounges, a large ballroom with a capacity of more than 1,000 guests, more than a dozen smaller conference rooms, and numerous retail stores, which merchandise such items as men's and women's clothing, jewelry, flowers,

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(footnote continued from previous page)
other's requested finding. Our finding is based on the parties' stipulation that Herb Alpert was a general partner, which is supported by Almo's 1976 Federal partnership return that stated that he was not a limited partner.

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newspapers, rental cars and gifts. Other site improvements include a 2-story, reinforced, concrete parking structure, a health club complex and a swimming pool.

During the taxable year at issue and all years relevant to these cases, Almo leased the hotel under a master lease to Ariz, a California limited partnership. Ariz subleased the hotel under an operating lease to Airportel, Inc. (Airportel) for management purposes.[5] Prior to August 1975, Airportel, a Florida corporation in the business of hotel management, was a wholly owned subsidiary of International Airport Hotel Systems, Inc. (IAHS). IAHS had agreed to guarantee Airportel's obligations as tenant under the terms of the operating lease, and, prior to 1975, the hotel operated under the name of the International Hotel.

During the early 1970's, IAHS and Airportel suffered financial difficulties, and substantial repair work, maintenance and capital replacements were not performed on the hotel for approximately 2 or 3 years. In 1975, IAHS was released from its guarantee obligations in exchange for the transfer of all of its Airportel stock to Almo and Ariz, 70 percent and 30 percent, respectively, transferred directly to their individual partners, plus $1,950,000 in cash and promissory notes. Almo and Ariz then negotiated with several hotel management concerns, including

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5 At trial it was stated that prior to 1975 the hotel was leased by Almo Enterprises to Airportel under a triple-net lease. In any event, we find that the hotel owners, Almo or Almo Enterprises, were not obligated to make repairs or capital improvements prior to 1975.

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the Hyatt Corporation (Hyatt), the Hilton Corporation (Hilton), and Mr. Brian Corbell, an independent operator who ran several hotels, with respect to assuming the management of the hotel's daily operations. During their negotiations, both Hyatt and Hilton recommended that approximately $2 million of repair work and capital improvements be made, and Mr. Corbell estimated total expenditures of approximately $600,000--$700,000. The individual partners of Almo and Ariz chose Hyatt to manage the hotel and thereafter the hotel's name was changed to the Hyatt House Hotel. An agreement (management agreement) was executed on August 13, 1975 between Hyatt and Airportel,[6] as lessee under the operating lease. Several amendments to the management agreement were executed between 1975 and 1981.

As a condition to the execution of the management agreement, certain hotel repair work, improvements and capital expenditures were deemed necessary. The structure of the building and its exterior were in very good condition, and one floor, as well as rooms by the pool area, had been remodeled recently. However, although the hotel remained in very good operating condition, its "tired" interior condition was plainly visible to Hyatt and petitioners. Specifically, from both a functional and aesthetic standpoint, the hotel's furnishings, fixtures and design were somewhat obsolete and required remodeling. Pursuant to the terms of the management agreement, a program of repairs and

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6 Certain exhibits refer to an entity known as Alar Corporation, which is a successor in interest to Airportel.

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improvements was proposed by Hyatt's technical assistance services division. Hyatt bore primary responsibility for deciding the specific work to be performed, subject to the final approval of the lessee, Airportel, referred to in the agreement as "Owner" of the premises. The program of repairs and improvements was incorporated directly within the management agreement, as set forth in the relevant portions of the following provisions:

RECITALS

* * *

G. In order to induce Hyatt to assume the management of the Existing Hotel, Owner proposes, alone or in conjunction with others, to make or cause to be made substantial repairs and improvements with respect thereto, as more fully described in Section 1.3 hereof.

* * *

AGREEMENT

* * *

1.3 Capital Improvements.

(a) Owner agrees, alone or in conjunction with others, to make or cause to be made, with respect to the Existing Hotel, capital improvements (which term, as used in this Section 1.3 and in Section 1.4 and the several subsections thereof, shall refer to (i) the refurbishing of the Existing Hotel, including any work of repair and maintenance, (ii) improvements, additions or alterations to the Existing Hotel, and (iii) the purchase and installation therein of additional personal property, including Operating Equipment and Furnishings and Equipment) at a total cost to Owner of not to exceed the sum of $2,000,000.00 (which sum is herein referred to as the "Limit").

The "total cost" to Owner of any such capital improvements is hereby defined to include * * * (ii) the cost of all work involved in the refurbishing, improvements, additions or alterations of or to the Existing Hotel, * * *.

(b) As soon as practicable, Hyatt shall submit to Owner for its approval a proposal and budget (the "Improvement Budget") setting forth, in reasonable

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> detail, a program of proposed capital improvements, * * *. Upon approval by Owner of the Improvement Budget * * * Hyatt, as agent of and for the account of Owner, shall, with reasonable diligence, cause to be prepared detailed plans and specifications designed to implement the capital improvements (the "Budgeted Capital Improvements") embodied in the Approved Improvement Budget, including detailed architectural plans and specifications (the "Architectural Plans") for the proposed capital improvements other than the New FFE and detailed plans and specifications (the "FFE Plans") for the New FFE, and shall furnish copies of each thereof to Owner for its advance approval. Such Architectural Plans and FFE Plans shall be prepared by architects, designers and other specialists selected by Owner with Hyatt's approval. * * *

The management agreement also provided that Hyatt was to loan to Airportel the funds necessary to finance such repairs, maintenance work and capital improvements, up to a total cost not to exceed the $2 million limit. Due to concerns that the newly acquired Airportel stock might be subject to potential but unknown liabilities, petitioners decided to segregate the money loaned by Hyatt into a separate entity. On September 15, 1975, the individual partners of Almo and Ariz formed a joint venture, Almo/Ariz, a California limited partnership, whose ownership interests were held by Almo and Ariz, 70 percent and 30 percent, respectively. Almo/Ariz was formed for the purpose of making the needed repairs and refurbishments to the hotel, and executed a nonrecourse note whereby Hyatt loaned to the partnership $2 million to finance the improvement program. On October 4, 1975, Almo/Ariz, as lessor, executed a lease agreement (FFE lease) with Alar, as successor in interest to Airportel, as lessee. The FFE lease was executed with respect to the leasing of

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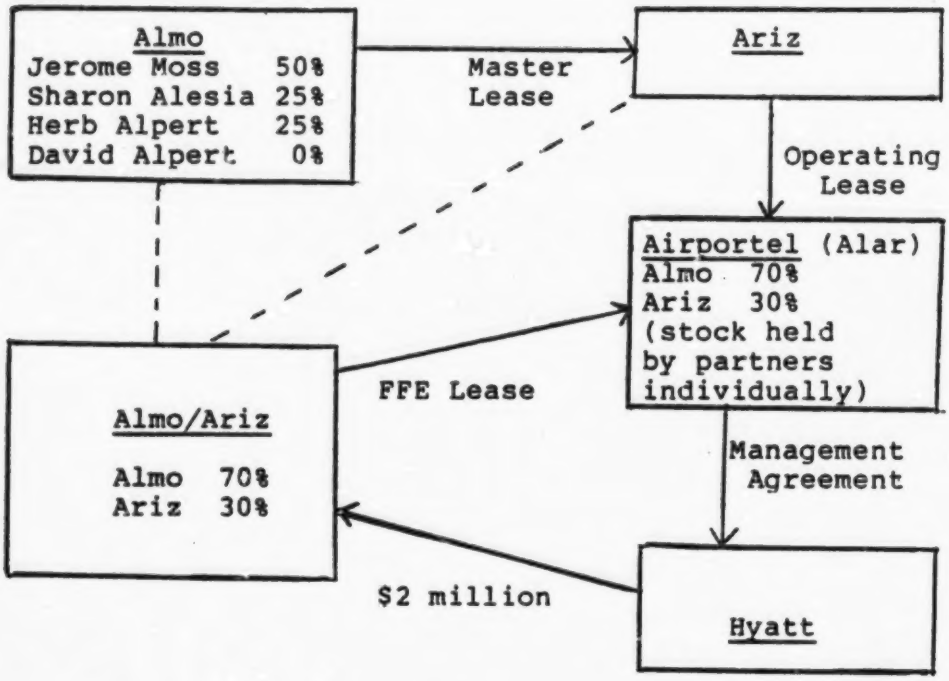
furniture, furnishings, machinery, equipment, fixtures, leasehold improvements and other property attached to or used in connection with the hotel, as purchased through the Hyatt loan.

The relevant relationships between the parties may be illustrated as follows:



All of the entities utilized the cash receipts and disbursements method of accounting to report their income, except Airportel, which used the accrual method.

The repairs and capital improvements required by the management agreement were commenced in November 1975 and were completed in 1976. Four hundred of the hotel's 620 guest rooms were remodeled completely. The complete remodels included both a so-called hard remodel, the replacement of hard goods, specifically furniture (beds, chairs, tables and lamps), and a

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so-called soft remodel, the replacement of soft goods, such as the carpeting, drapes and bedspreads. At the same time, the guest rooms were gutted, repainted and newly wallcovered. Additionally, public areas of the hotel were upgraded. Two hotel restaurants and a bar were remodeled, as were the first floor lobby and second floor ballrooms and meeting rooms. New supplies were acquired bearing the Hyatt logo on hotel signs, uniforms, folios, dishes, glassware, and linens.

Almo/Ariz capitalized the following improvements financed by the Hyatt loan:

Capital Improvement	Cost
Electric "Hyatt House" sign	$ 58,278
Carpeting	251,692
Drapes	178,288
Hotel furnishings	696,510
Dining and kitchen furnishings	297,562
Office equipment	4,585
Total	$1,486,915

Almo/Ariz reported repairs and depreciation expenditures financed by the Hyatt loan as follows:

	1975	1976
Repairs and Maintenance	$132,140	$270,268
Depreciation	1,452	109,185

In May 1977, Almo/Ariz transferred to Airportel all of the capital improvements financed by the Hyatt loan pursuant to the management agreement, and thereafter Airportel claimed depreciation deductions with respect to these items.

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In the statutory notices of deficiency, respondent determined deficiencies in petitioners' 1976 Federal income taxes based on Almo/Ariz's $270,268 deduction for repairs and maintenance work, which respondent determined to be expenditures pursuant to a plan of capital improvements. Each petitioner's deficiency computation was derived from its respective flow-through partnership interest in Almo, based on Almo's 70-percent partnership interest in Almo/Ariz.

OPINION

The sole issue for decision is whether respondent has properly disallowed deductions claimed by Almo/Ariz and reported by petitioners based on their respective partnership interests in Almo. Petitioners have deducted certain expenses attributable to hotel repairs as ordinary and necessary business expenses. Respondent has determined that the expenses must be capitalized pursuant to a plan of capital improvements. Petitioners bear the burden of proof. Rule 142(a); Welch v. Helvering, 290 U.S. 111, 115 (1933).

In the 1975[7] and 1976 taxable years, Almo/Ariz incurred substantial expenses for repairs, maintenance work and capital improvements to remodel and refurbish the Hyatt hotel owned by petitioners. All expenses were incurred pursuant to the management agreement executed between Hyatt and Airportel, and

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[7] Respondent did not determine any deficiencies with respect to petitioners' Federal income taxes in the 1975 taxable year, so that any expenses incurred in that year are not at issue in these cases.

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were financed by the $2 million loan from Hyatt to Almo/Ariz. The accountant for Airportel and Almo/Ariz reviewed the invoices received with respect to all of the work performed in accordance with the improvement program and classified the expenses as either repairs deductible under section 162,[8] totaling approximately $400,000, or capital expenditures under section 263,[9] totaling approximately $1,500,000.[10]

The classification of expenses as either deductible repairs or capital expenditures is a question of fact that is often difficult to determine. Plainfield-Union Water Co. v. Commissioner, 39 T.C. 333, 337 (1962). Generally, repairs are incidental expenses that keep property in its ordinarily efficient operating condition but neither materially add to its value nor appreciably prolong its life. Section 1.162-4, Income

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8 Section 162 provides, in part, as follows:

TRADE OR BUSINESS EXPENSES.
(a) In General.--There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.

9 Section 263 provides, in part, as follows:

CAPITAL EXPENDITURES.
(a) General Rule.--No deduction shall be allowed for--
(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. * * *

10 Respondent does not contest Almo/Ariz's additional deduction of approximately $100,000 as ordinary and necessary business expenses for hotel kitchen and office supplies, such as dishes, glasses, and paper goods.

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Tax Regs.; Bloomfield Steamship Co. v. Commissioner, 33 T.C. 75, 84-85 (1959), affd. per curiam 285 F.2d 431 (5th Cir. 1961); Jones v. Commissioner, 24 T.C. 563, 568 (1955), affd. 242 F.2d 616 (5th Cir. 1957); Illinois Merchants Trust Co. v. Commissioner, 4 B.T.A. 103, 106-107 (1926). In comparison, capital expenditures put property into suitable operating condition and include permanent improvements or betterments and amounts expended in the restoration of property. Capital expenditures add to the property's value, substantially prolong its useful life or adapt it to a new or different use. Examples of capital expenditures are costs of furniture, fixtures and similar property having a useful life substantially beyond the taxable year. Section 1.263(a)-1, -2, Income Tax Regs.

In the instant case, the parties have stipulated that the particular items deducted by Almo/Ariz as repairs "were of the type (i.e., painting, wallcovering, etc.) of items that normally qualify as repair expense items."[11] Consequently, petitioners have not introduced evidence with respect to the specific items that were deducted as repairs. Therefore, the issue here is more narrowly stated as whether certain expenses that normally would

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11 This stipulation is somewhat confusing, as it also states that respondent does not concede that the usage of the term "repair(s)" is intended as a concession that such expenses do in fact meet all of the requirements of a deductible repair expense. Furthermore, respondent specifically states that he preserves his argument that these repairs do not constitute repairs and maintenance that keep the hotel in an ordinary and efficient operating condition. However, given our ultimate findings we do not address this issue.

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qualify as deductible repairs must be capitalized because they were incurred pursuant to an overall plan of capital improvements.

It is well established that expenses incurred as part of a plan of capital improvements, such as a plan of rehabilitation, remodeling or renovation, must be capitalized as part of the plan, even though these same expenses would have been deductible if they had been incurred in isolation or merely as periodic repairs. Cowell v. Commissioner, 18 B.T.A. 997, 1002 (1930), cited in Bloomfield Steamship Co. v. Commissioner, 33 T.C. at 84; Jones v. Commissioner, 24 T.C. at 568; California Casket Co. v. Commissioner, 19 T.C. 32, 38 (1952).[12] The determination of whether expenses are to be capitalized pursuant to a plan of capital improvements is a question of fact. United States v. Wehrli, 400 F.2d 686, 690 (10th Cir. 1968); Home News Publishing Co. v. Commissioner, 18 B.T.A. 1008, 1010 (1930). Among the factors to be considered are the purpose, nature, extent, value and effect of the work performed. Oberman Manufacturing Co. v. Commissioner, 47 T.C. 471, 482 (1967); Bloomfield Steamship Co. v. Commissioner, 33 T.C. at 84.[13] We find that, based on an

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12 See also Bane v. Commissioner, T.C. Memo. 1971-31, affd. per curiam (7th Cir., July 7, 1972); 4A J. Mertens, Law of Federal Income Taxation, sec. 25.56, at 217 & 221 nn. 22-28 (1985 rev.).

13 See also Seahill Co. v. Commissioner, T.C. Memo. 1964-56; Bank of Houston v. Commissioner, T.C. Memo. 1960-110.

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analysis of these factors, a general plan of capital improvements was in effect during the taxable year in issue, specifically, for the renovation, remodeling and improvement of the hotel.

The purpose underlying the program of expenses was to perform work deemed necessary by petitioners and Hyatt as a result of Airportel's and IAHS's failure to repair, maintain and perform capital improvements for approximately 2 to 3 years during the early 1970's. Even though the hotel had remained in good operating condition, its "tired" condition was plainly visible. Its furnishings, fixtures and design were obsolete and required remodeling both from a functional and aesthetic standpoint. Petitioners and Hyatt agreed that substantial work was necessary. As a condition to the execution of the Hyatt management agreement in 1975, an extensive program of repairs and improvements was to be implemented during 1975 and 1976 as financed by a loan from Hyatt.

The importance of this program of improvements is illustrated in the testimony of Mr. Hugo Friend, who in 1975 was president, director and chief executive officer of Hyatt. At trial, Mr. Friend testified that the terms of this particular management agreement were "a little bit unique" in that Hyatt usually did not advance the funds necessary to finance repairs and improvements. He testified that "[i]n this case it was necessary to get the contract." The management agreement required the completion of "substantial repairs and improvements," as set forth in the agreement as "capital

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improvements." Capital improvements are referred to therein as refurbishing, which specifically includes repairs and maintenance, as well as improvements, additions and alterations to the hotel. The agreement clearly provides for a single and complete program of improvements, which includes expenditures for work that standing alone otherwise might qualify as deductible repairs and maintenance.

The nature and extent of the work performed also is in accordance with a plan of renovation and remodeling. Virtually all of Hyatt's $2 million loan was spent, with approximately $1,500,000 for capital improvements and $400,000 for repairs and maintenance. Mr. Friend testified at trial that, due to the previously postponed maintenance of the hotel in the early 1970's, the amount of total expenditures necessary was "on the high side." The specific details of the improvement project were designed by Hyatt's technical assistance services division and encompassed work to a substantial portion of the hotel. The work included the complete remodeling of 400 of the hotel's 620 guest rooms and the upgrading of public areas, such as the hotel lobby, second floor ballrooms and meeting rooms, two restaurants and bar. The particular items deducted as repair expenses, for example, for painting and wallcoverings, were pursuant to this general scheme of improvements. Although improvements were not made to the hotel's structure, the useful life of the capital

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improvements was anticipated to be approximately 3 to 5 years. The plan of improvements doctrine requires that the entire cost of all the expenses must be capitalized.

The effect of this plan of improvements was to increase the value of the hotel property. Even though the hotel always enjoyed high ratings, and the improvements did not constitute a change in use, the hotel's overall condition was upgraded as a result of the improvement project. Following the completion of this work, hotel occupancy rates increased as did room rates. This may be attributable in part to generally improved economic conditions and the cyclical nature of the hotel industry. However, the hotel's newly acquired four-star rating in 1978 is evidence that as a Hyatt hotel the value of the property did increase within the hotel industry.

Petitioners cite two cases in which this Court held for the taxpayers that certain repair expenses were deductible because there were no plans of capital improvements, Keller Street Development Co. v. Commissioner, 37 T.C. 559 (1961), affd. in part and revd. in part on another issue 323 F.2d 166 (9th Cir. 1963), and Kaonis v. Commissioner, T.C. Memo. 1978-184, affd. in an unpublished opinion 639 F.2d 788 (9th Cir. 1981). We note that the appellate court did not provide any discussion of the issue for decision here in either of these cases. However, because both of these cases were appealed to the Court of Appeals

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for the Ninth Circuit, to which this case would be appealable, we set forth our reasons to distinguish these cases from the instant case.

In Keller, this Court held that capital improvements made to the taxpayer's brewery to increase its productive capacity did not constitute a "general betterment program." 37 T.C. at 568. The decision was based on the fact that the brewery was in good operating condition and use as of the taxable year in issue and during several prior years. The taxpayer had begun to modernize its plant and facilities during the middle of World War II and continued to do so until 1952. In the instant case, although the hotel may have been in good operating condition in 1975, substantial repair work, maintenance and capital improvements had not been performed for the prior 2 or 3 years, and its "tired" condition was plainly visible. Petitioners and Hyatt agreed that the hotel's furnishings, fixtures and design were obsolete and required remodeling. An improvement program was developed and encompassed extensive work with respect to a substantial portion of the hotel. The remodeling work improved the hotel's condition both aesthetically and functionally.

In Kaonis, this Court held that the repairs performed by the taxpayer merely restored the property to its prior condition but did not add to its value nor prolong its life. We concluded that because the rental property was tenantable and generally suitable for use in the taxpayer's trade or business the repairs were not part of a "plan of total rehabilitation." 37 T.C.M. 792, 796, 47

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P-H Memo T.C. par. 78,184 (1978). In the instant case, the painting, wallcoverings and other repairs were merely incidental to a $2 million improvement project, which substantially upgraded the overall condition of the hotel. The capital improvements for remodeling were estimated to have a useful life of approximately 3 to 5 years, which added to the life of the hotel property. Furthermore, although the hotel may have been generally suitable for use as a hotel, its condition as of 1975 clearly was not suitable to petitioners and Hyatt, who, as a condition to the execution of the new management agreement, required substantial repairs and capital improvements. We also note that the work performed made the hotel better suited for the purposes for which it was used and, specifically, better suited for its new management concern, Hyatt.[14] Therefore, here the repairs, maintenance and capital improvements clearly added to the value of the property.

We reject petitioners' argument that the repair work merely was consistent with the hotel's ongoing program of repairs and maintenance. It has been established that substantial work had been deferred during the years prior to management of the hotel by Hyatt. Petitioners' argument that the 1975-1976 expenditures were consistent with expenditures incurred annually from 1977 through 1984 also tends to indicate that such expenses are more consistent with Hyatt's management style and recommendations,

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14 See Seahill Co. v. Commissioner, T.C. Memo. 1964-56, and Bank of Houston v. Commissioner, T.C. Memo. 1960-110.

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rather than any such ongoing program of petitioners. It should be noted that our findings here do not suggest, as petitioners contend, that regular, annual plans of maintenance and repairs necessarily constitute plans of capital improvements, absent a showing of actual work performed of the scope and magnitude of the improvements, renovations and remodeling as are present in the instant case. Finally, we note that petitioners have failed to provide authority for their argument on brief that a plan of capital improvements requires creation of a "new asset."

Accordingly,

Decisions will be entered for respondent.

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T. C. Memo. 1986-129

UNITED STATES TAX COURT

MORRISON INCORPORATED; MORRISON CAFETERIA COMPANY OF SAVANNAH, INCORPORATED; MORRISON CAFETERIA COMPANY OF WOODLAND HILLS, INC.; MORRISON INCORPORATED OF TENNESSEE; MORRISON CAFETERIA COMPANY, INC.; MORRISON CAFETERIA OF COLUMBIA, SOUTH CAROLINA, INC.; MORRISON CAFETERIA COMPANY OF JEFFERSON PARISH, INC.; MORRISON SUPPORT COMPANIES OF GEORGIA, INC.; MORCO INDUSTRIES, INC. (FORMERLY MORRISON SUPPORT COMPANIES OF FLORIDA, INC.) AND MORRISON FOOD SERVICES OF VIRGINIA, INC., Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 34300-83. Filed March 31, 1986.

Thomas W. Power and Tracy J. Power, for the petitioners.

Robert W. West, for the respondent.

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MEMORANDUM FINDINGS OF FACT AND OPINION

SCOTT, Judge: Respondent determined deficiencies in petitioners' Federal income taxes in the amounts and for the years as follows:

Petitioners	Year Ending	Deficiency
Morrison Cafeteria Company of Columbia, South Carolina, Inc.	May 28, 1977	$ 4,204.40
	June 3, 1978	19,164.50
Morrison Cafeteria Company of Jefferson Parish, Inc.	May 31, 1975[1]	9,144.00
	May 28, 1977	127,407.82
	June 3, 1978	14,389.50
Morrison Support Companies of Georgia, Inc.	May 28, 1977	1,259.80
	June 3, 1978	4,455.61
Morco Industries, Inc. (Formerly Morrison Support Companies of Florida, Inc.)	June 3, 1978	3,486.40
Morrison Food Services of Virginia, Inc.	May 31, 1975[1]	5,313.53
	May 28, 1977	6,471.00
Morrison, Inc.	May 28, 1977	142,929.00
	June 3, 1978	138,248.24
Morrison Cafeteria Company of Savannah, Inc.	May 28, 1977	4,140.40
	June 3, 1978	3,653.00
Morrison Cafeteria of Woodland Hills, Inc.	May 28, 1977	14,273.20
	June 3, 1978	39,468.70
Morrison Incorporated of Tennessee	May 28, 1977	7,874.18
	June 3, 1978	28,075.00
Morrison Cafeteria, Inc.	May 28, 1977	158.60
	June 3, 1978	13,521.71

Some of the issues raised by the pleadings have been disposed of by agreement of the parties, leaving for our

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[1] These deficiencies result from disallowance of net operating loss carrybacks.

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decision only whether petitioners are entitled to investment tax credits granted by section 38[2] for any or all of 19 categories of assets that were purchased and installed in cafeterias constructed by petitioners during the fiscal years ending May 28, 1977 and June 3, 1978, and a portion of the costs of the primary electrical distribution systems installed in their cafeteria buildings during these years.[3]

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2 Unless otherwise stated, all statutory references are to the Internal Revenue Code of 1954, as amended and in effect during the years here in issue.

3 After the parties reached an agreement on the eligibility of certain items with respect to which the investment credit was disallowed in the notices of deficiency, the credit with respect to the following items with the indicated expenditure remain in issue:

	Item	Expenditure
1.	Emergency lighting	$ 95,967
2.	Kitchen panel boards	116,850
3.	Kitchen hand sinks	21,392
4.	Kitchen water piping	189,214
5.	Eliason doors	15,930
6.	Restroom accessories	54,240
7.	Decor window treatment	3,713
8.	Lattice millwork	2,134
9.	Vanity cabinets and counters	1,931
10.	Customer line screen	111,422
11.	Serving line concrete curb	12,406
12.	Kitchen heat recovery unit	23,859
13.	Cooler, freezer and garbage room floors and the garbage room	149,094
14.	Kitchen sanitary wall and floor tile	919,557
15.	Kitchen air makeup unit	473,560
16.	Kitchen drainage	364,977
17.	Electric water coolers	15,287
18.	Chandeliers, decor wall lights, dimmers and installation	178,871
19.	Kitchen hot water heater	60,734
20.	Primary electrical distribution system	699,884*

(footnote continued)

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FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly.

Petitioners consist of Morrison, Inc., and nine related corporations.[4] The principal place of business of each petitioner was Mobile, Alabama, at the time the petition in this case was filed. Petitioners filed their original and amended Federal corporate income tax returns for the years in issue with the Internal Revenue Service Center, Atlanta, Georgia.

Petitioner, Morrison Inc., is the parent corporation of the remaining petitioners. During the years at issue, petitioners owned and operated several diverse businesses,

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(footnote continued from previous page)

* Petitioners filed claims for refunds for their expenditures for the primary electrical distribution systems in the total amount of $699,884. The refund claimed is 10 percent of this amount or $69,988.40.

4 These corporations and their State of incorporation are as follows:

Name	State of Incorporation
Morrison Inc.	Florida
Morrison of Savannah	Georgia
Morrison of Woodland Hills	Mississippi
Morrison of Tennessee	Tennessee
Morrison Cafeteria Co., Inc.	Alabama
Morrison of Columbia, S.C.	South Carolina
Morrison of Jefferson Parish	Louisiana
Morrison Support Co. of Georgia	Georgia
Morco Industries	Florida
Morrison Food Services of Va.	Virginia

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but their primary business was the operation of public cafeterias. The corporation began in 1920 with the opening of the first cafeteria in Mobile, Alabama. The business has grown so that by May 1977 it included 101 cafeterias and by June 1978 included 117 cafeterias. Over the years Morrison Inc. has organized or acquired subsidiary corporations to provide food to the cafeterias, roast and grind coffee, manufacture cleaners and detergents, supply food service equipment, manufacture furniture and kitchen equipment, supply interior accessories and decorations, build cafeterias, provide insurance for cafeterias and provide advertising services. Petitioners offer in excess of 100 menu items to the public each day, including numerous items in the categories of appetizers, salads, soups, entrees, vegetables, fruits, breads, desserts and beverages. Petitioners receive volume shipments of food products, including raw food products such as dressed turkeys and chickens and frozen and fresh vegetables. Petitioners uncrate and unpackage the food products and prepare them for public consumption by cooking, frying, baking or broiling. Petitioners are subject to all applicable local health codes and regulations governing the operation of restaurants. These codes and regulations are in addition to those which govern businesses and buildings generally and may set standards or guidelines for preparation and cooking of food, cleanliness, sanitation, employee dress and other related

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areas. Before a restaurant can open to the general public, a certificate of occupancy must be issued which certifies compliance with all relevant codes and regulations. Continuous compliance is also insured by frequent unannounced inspections by public health officials charged with the enforcement of such codes and regulations.

Emergency Lighting.

Emergency lighting consists of lights, batteries, and connections to a building's electrical system. Both wall-mounted and ceiling-mounted models were used by petitioners. The emergency lights were constructed so that their batteries were continuously charged by the building's electrical system and when electrical power was interrupted, the lights would automatically switch to battery power and be turned on. The lights were designed to illuminate large areas of the cafeteria during electrical power failures so customers are able to finish eating their meals during a power outage. In petitioners' cafeterias customers pay for their meal after eating when they exit the cafeterias.

The use of emergency lighting in cafeterias is required by the health and safety codes of each State in which petitioners operate, and the number of emergency lights required is based upon the seating capacity and square footage of the cafeteria. Petitioners' cafeterias may require more emergency lights than a retail store such as a furniture store would require, but each of petitioners'

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cafeterias had more than the required number of emergency lights. Emergency lights located in the dining rooms were ceiling-mounted models, and wall-mounted models were generally confined to the kitchen. In petitioners' Williamsburg facility, there were 16 emergency lights in the dining room and 3 in the serving line area which would be considered ceiling-mounted models. There were six emergency lights in the kitchen area which would be considered wall-mounted models. The ceiling- or wall-mounted models could be self-contained units that were plugged into a normal electrical outlet but the majority were wired directly to the building's electrical system.

Kitchen Panel Boards.

Kitchen panel boards are electrical panel boxes containing circuit breakers that are used to distribute electrical power to the kitchen equipment, but not to lighting, cooling or heating facilities in petitioners' cafeterias. The kitchen panel boards receive electrical power from lines connected to the main panel boxes for each cafeteria (which in turn receives power from outside lines) and distribute power to the kitchen equipment, electric water cooler and wall receptacles through lines connected to the output circuit terminals. The output circuits are graded by size of amperage to conform to the needs of the various pieces of kitchen equipment. The circuits from the kitchen panel boards provide power to kitchen equipment both

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tnrough direct connections to larger equipment and through wall receptacles. Some circuits to larger equipment have in-line switches between the equipment and the kitchen panel boards to allow interruption of electrical power if necessary. The kitchen panel boards are placed in the cafeterias during the construction of a new cafeteria. The circuits in the panel board may be modified from time to time as electrical requirements dictate.

Each circuit running from the kitchen panel boards supplies electricity to one piece of kitchen equipment. Each circuit leads from a panel board to a specific piece of equipment and back to the panel board. A panel board has room for installation of many circuits. Each circuit requires a circuit breaker to be installed in the panel board and wires lead from the circuit breaker to the equipment. In order to change a circuit or to change minimally the circuit's capacity, a simple change of the circuit breaker on the panel board is necessary. A change from 15 amps to 20 amps is a minimal change that can be accomplished in approximately 5 minutes. In order to increase the power from 15 amps to 50 amps, however, the original conduit must be abandoned, a new conduit must be rercuted and new conductors must be run through it. Panel boards are standard electrical equipment and are not designed and purchased especially for specific machinery or equipment. Panel boards can be used and adapted to supply

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electricity to almost any type of electrical appliance or equipment. The kitchen panel boards in issue constitute approximately 50 percent of petitioners' total expenditure for panel boards.

Kitchen Hand Sinks.

Petitioners provide one or more hand sinks in the kitchen areas to facilitate the washing and cleaning of employees' hands during working hours. The number and location of these sinks are generally determined by local health codes and regulations. Local health codes prohibit employees from washing their hands in the food preparation sink. The sinks in issue are connected to the general plumbing of the building and to the sanitary sewer. The sinks are constructed generally of stainless steel and have large control handles capable of being operated by the employee by using only his elbows or feet. The kitchen hand sinks are part of the original design of a new cafeteria and are placed in use when the cafeteria opens. The kitchen hand sinks are bolted to the walls of the kitchen and are connected to the building's water and sanitary sewer system. If a cafeteria is closed, the kitchen hand sinks are normally removed from the wall by disconnecting them from the water supply and sanitary sewer.

Kitchen Water Piping.

The kitchen water piping is designed to deliver clean water to various equipment located in the kitchen area and

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the food serving line. The kitchen water piping also delivers water to the kitchen hand sinks and electric water coolers. The kitchen water piping is described as the piping which branches off of the main water lines of the building and brings water to the kitchen area and food serving line. The kitchen water piping is connected to sinks, water coolers and various items of equipment requiring water for operation. The kitchen water piping connects to equipment used for the following purposes:

(1) Cleaning and rinsing produce.
(2) Cleaning, soaking and rinsing meat, fish and other meat products prior to cooking.
(3) Preparation of food.
(4) Cleaning of employees' hands in kitchen hand sinks.
(5) Cleaning of pots, pans and other utensils.
(6) Ice machines.
(7) Drinking fountains.
(8) Cleaning of kitchen equipment and kitchen area.

The kitchen water piping is installed during the construction phase of a new cafeteria but may be modified with the introduction of new equipment requiring a water source. Once construction is completed, the only visible portion of the piping is that portion which extends to connect with a sink, water cooler or other equipment. The remainder of the piping is buried below the cafeteria's concrete and tile floor or behind the gypsum board walls. The kitchen water piping leads to specific equipment. If petitioners' kitchen equipment were replaced or changed,

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petitioners could use the same water lines for the new equipment.

Eliason Doors.

Eliason doors are double-action doors installed between the serving line area and the kitchen area. This door is self-closing and lightweight so that employees may open and close the door while carrying food trays in their hands. The doors have a glass panel inset and swing open in both directions to permit easy passage between the kitchen area and the serving line area. The doors are purchased by petitioners as a package containing the door, hinges and centering device. Petitioners furnish the door frame separately.

Restroom Accessories.

Restroom accessories include paper towel dispensers, electrical hand dryers, cup dispensers, purse shelves, toilet tissue holders, stainless steel soap dispensers and holders, sanitary napkin dispensers and waste receptacles, coat hooks, bars for the handicapped, framed mirrors with shelves and ashtrays. All of these items are not found in all restrooms. These items are either built into or fastened onto the restroom walls or metal partitions at the time the building is constructed, but may be replaced or modified at a later time. These restroom accessories are the type of accessories generally found in any public restroom. The restroom accessories are in both the customer

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and employee restrooms of the cafeterias. Petitioners have not removed any of the accessories in issue from the restrooms while the restrooms are in operation, unless the removed item is replaced with another similar accessory. The restroom accessories are attached to the restroom's tile wall either by drilling a hole in the wall and using a toggle bolt to bolt the accessory to the wall, or a space is provided for the accessory when the wall is constructed and the accessory is later installed in the space provided.

Decor Window Treatment.

The decor window treatment consists of a false window built into an interior wall. A light fixture is mounted flush on an interior wall and is covered with a translucent lens. The fixture is then framed in and finished with millwork to resemble a window. The decor window treatment is designed to simulate a window and not to provide the customer with lighting. The decor window treatment is constructed during the initial construction phase of a new cafeteria. It would be possible to remove decor window treatment and reuse it in a subsequent cafeteria location. Construction of decor window treatment on an interior wall was accomplished by framing in the window out from the wall with only the lighting fixtures recessed into the wall. If the window treatment was constructed on an exterior wall, it was constructed on top of the surface of the wall and was built to resemble a frame protruding out from the wall.

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When petitioners redecorated a cafeteria every 5 years, they often eliminated or changed the decor window treatment.

Lattice Millwork.

The lattice millwork consists of decorative panels made with lattice material approximately 1-3/8 inches x 1/4 inch secured together at right angles that form a diamond shape design. The lattice gridwork was often placed over a wall which is covered with decorative wall coverings in order to simulate an outside garden. The lattice millwork could also be installed between two stationary upright partitions in order to produce a screen between two dining areas. Portions of the lattice millwork were removed, repainted and reused by petitioners in another location when a cafeteria was closed or redecorated.

Vanity Cabinets and Counters.

The vanity cabinets and counters are constructed in restrooms to provide an area for a customer's personal grooming. The vanity cabinets and counters at issue in this case are those provided for petitioners' customers rather than their employees. Petitioners used two types of vanity counters and cabinets in their restrooms. One type was a countertop braced or bracketed to the wall of the restroom and covered with a laminated plastic top. The second type was a full cabinet, placed on the restroom floor and bracketed to the restroom wall. Both types had cutouts for insertion of sinks. The vanity cabinets and counters

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were constructed by a cabinet maker during the final construction stage of the cafeteria. The cabinet was like any other cabinet found in many public restrooms. The counter was constructed from a two-by-four wood frame, covered by plywood, and was finished with a plastic laminate coat.

Customer Line Screen.

The customer line screen is the divider that separates the dining room area from the customers waiting to enter the serving line. Typically, this divider begins near the entrance door and runs along one side of the cafeteria to the serving line in the rear of the cafeteria. Framed openings are usually constructed within the customer line screen to eliminate the tunnel-line appearance of a long hall. Lattice work, spindles, or another open divider are constructed within the framed openings. The entire divider is constructed in the initial construction phase of a new cafeteria. It is usually anchored to the floor and ceiling by screws or nails. The portion of the customer line screen not constituting the framed openings is constructed using wood or metal studs, plates and blocking, and is covered with gypsum wallboard (sheetrock), plywood, paneling or other material. The wallboard or other covering may itself be covered with wallpaper or other decorative covering, such as vinyl, fabric or brick veneer, stain or paint. Portions

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of the customer line screen were often removed and reused by petitioners at other locations.

Serving Line Concrete Curb.

The serving line curb is a concrete curb that runs the full length of the serving line, wrapping around the end of the serving line and running partially in the rear of the serving line. The curb is a built-up concrete curb covered with a grouted quarry tile veneer. The curb is constructed during the initial construction phase of the cafeteria and it prevents water and spills from behind the serving line from reaching customers in front of the line and it aids in cleaning the floor. The curb also conceals legs and open space under the serving line steam tables and other equipment. Neither the serving line tables nor the equipment rests on the serving line curb. Such equipment is all freestanding. It is not practical to move a serving line concrete curb because of its construction. A new curb will be built in another cafeteria if petitioners close or sell an existing cafeteria. Serving line concrete curbs are similar, although not identical, to those found in meat markets and grocery stores under counters displaying products for sale.

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Kitchen Heat Recovery Unit.

The kitchen heat recovery unit reduces the cost of heating water for petitioners' cafeterias by collecting heat from the air conditioning system and refrigeration units and using it to preheat cold water to about 110 to 120 degrees before it goes into the cafeteria's hot water heater where it is boosted to 140 or more degrees. Heat is collected, transferred and released by use of a closed-loop, water heat exchange system. This system preheats cold water in a storage tank that has been filled from the municipal water system. The kitchen heat recovery unit is used in conjunction with the cafeteria's plumbing system in providing hot water for kitchen equipment such as the pot sink and dishwasher. The heat recovery system makes efficient use of hot gases which would otherwise be wasted by using such gases to heat water.

The kitchen heat recovery unit is installed with a series of pipes connecting the cold water source, a storage tank and the hot water heater. It also has a series of pipes connecting the air conditioning and heating unit from which it draws the hot gases. Due to the method of installation and the pipes running in the walls, floor and ceiling of the cafeteria, the heat recovery unit is difficult to remove, although it is possible to move the exposed components. The hot water heated by the heat recovery unit generally is used in the public and employee

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restrooms as well as for cooking and cleaning functions, although a few cafeterias have a separate hot water heater for the public restrooms. The public restrooms which are serviced by the heat recovery unit use approximately 1 percent of the hot water generated by the unit. Equipment such as the dishwasher uses 5-1/2 gallons of 180 degree water a minute for the 8 to 9 hours a day it is in use. The heat recovery unit is adaptable to any business that generates hot gases from air conditioning and refrigeration operations and also consumes large volumes of hot water in operating other equipment.

Cooler, Freezer and Garbage Room Floors and the Garbage Room.

The cooler, freezer and garbage room floors are constructed with a concrete slab on top of layers of insulation and are more than twice the depth of the floors in the remaining kitchen area. The insulation is necesary to help maintain the cool temperatures and to prevent the kitchen floor from buckling and cracking which may result from the cold temperatures in the freezer causing a buildup of moisture and resulting in a settling of the soil and foundation. The floors are built with the additional insulation when a cafeteria is constructed.

The construction of the cooler, freezer and garbage room floors is as follows: a 4-inch concrete slab is covered with 4 inches of insulation, which is covered by a

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3-1/2-inch concrete slab topped with a layer of quarry tile which is set on epoxy and grouted with epoxy. The floors are constructed so that they are only 5/8 inch above the height of the floors in the normal working area of the kitchen.

The refrigerated garbage room is used to store garbage until it can be removed by municipal garbage collectors. Storage in this manner is generally required by local health codes. The garbage room is constructed of concrete blocks with insulation applied to the interior walls and ceiling surface. Insulated panels are then used to cover the walls. The garbage room is part of the building but is accessible only from outside the cafeteria. There is no inside entrance to the garbage room. The garbage room temperature is maintained between 50 to 55 degrees in order to reduce odors and control insects.

Kitchen Sanitary Wall and Floor Tile.

The kitchen sanitary wall is a ceramic tile wall extending from approximately 6 inches above the floor completely to the ceiling. The kitchen floor tile in issue is a quarry tile floor covering the entire floor area and extending up the walls to meet the ceramic wall tile which is approximately 6 inches up from the floor. The quarry tile has a somewhat rougher surface than the ceramic tile to prevent employees from slipping or falling. The tile floors and walls are constructed during the initial construction

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phase of the cafeteria. The tile is installed by placing the individual pieces or mats of connected pieces on a wet mortar cement base and a grout mixture is placed in the openings between the tiles. The tile walls and floors are easily cleaned and repetitive cleaning does not harm the appearance of the tile. The tiles are also very wear resistant.

Petitioners are required by local health codes to have the kitchen floors and walls covered with a smooth surface that can be cleaned easily. Petitioners use tile on the walls and floors of their cafeterias in order to facilitate cleaning and maintenance of the kitchen area. After the mortar and grout have dried, removal of the tiles is difficult and expensive.

Kitchen Air Makeup Unit.

The kitchen air makeup unit is a ventilation system consisting of a roof-mounted fan or blower, ductwork, and ceiling diffusion grids and it may or may not contain heaters. The purpose of the kitchen air makeup unit is to ventilate the air in the kitchen area of petitioners' cafeterias and to replace the air exhausted from the kitchen by the range exhaust hoods with fresh outside air via air ducts and ceiling outlets. Petitioners are required by local building codes to exhaust approximately 24,000 cubic feet of air per minute from the kitchen due to the extensive cooking in that area. The range exhaust hoods expel large

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quantities of air containing smoke and odors from the kitchen and the kitchen air makeup unit replaces the exhausted air. Without the air makeup unit, a vacuum would be created in the kitchen area due to the great amount of air that must be exhausted. During the years in issue, prior to installation of air conditioners in petitioners' kitchens, temperatures in the kitchen during the summer could exceed 120 degrees without the air makeup unit bringing fresh air into the kitchen.

During the years in issue, the kitchen area was not air conditioned and air supplied by the kitchen air makeup unit was not air conditioned. However, in certain regions the air may be heated when the outside temperature requires heating. Petitioners installed heaters in the kitchen air makeup units for all cafeterias located north of Ocala, Florida. There were no heaters in the kitchen air makeup units for cafeterias located south of Ocala, Florida. The kitchen air makeup units are not used for air conditioning and heating of the customer dining area. That area is served by a different air conditioning/heating system.

The kitchen air makeup units supply 90 percent of the replacement air for air exhausted from the kitchen. The remaining 10 percent of air is replaced from the dining room of the cafeterias to prevent kitchen odors from entering the dining room.

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The air makeup unit is located either on the roofs of the cafeterias or between the finished ceilings and the roofs. The ductwork is located between the ceilings and the roofs. The only part of the system visible from the kitchen area is the grating located in the kitchen ceilings.

Kitchen Drainage.

The kitchen drainage in issue represents several components used in a system that drains water and liquid waste from the kitchen sinks and floors through piping to a grease trap pretreatment unit and then onto the connection with the local sanitary system. Included in the kitchen drainage system are floor drain covers, open air drains, recessed openings in the slab floor, P traps, Y connections, T connections, piping and pipe connections, and grease traps. The components are constructed together to form a drainage system during the construction phase of a new cafeteria. Only the floor drain covers and the recessed openings are visible once the cafeteria is placed in service. The remainder of the system is concealed in the slab floors, behind finished walls or is buried in the ground outside the cafeterias.

There are two types of drains used in petitioners' cafeterias. The first type is the hub, or open air drain. This drain allows an air gap to the drainage system and the equipment being drained. This type of drain is required by local health codes for equipment in which food is prepared.

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The open air drain prevents waste from being flushed back into the equipment through the drainage system. The second type of drain is the floor drain, which consists of grates in the floor connected to the drainage system. The floor drains are used to drain wash water from the floor after the area has been cleaned. The floor drains can also be located immediately beneath a piece of equipment and serve the same purpose as a hub drain.

In the hub drain, a pipe from the equipment being drained leads to a larger opening, or hub, into which the waste drains. There is an air gap between the receiving hub and the discharging pipe from the equipment. There is no special connector used in this drain.

The grease trap pretreatment units which collect the waste from the kitchen drains are located outside of the cafeterias. A grease trap is an enclosed chamber installed in the ground near the cafeteria. It is designed to receive waste water from the kitchen drainage system and pretreat the influent by removing grease and food particles prior to discharging the waste water into the municipality's sanitary sewer system. The grease trap must be of sufficient size to permit an adequate detention period to allow suspended grease to float to the top of the tank and food particles to settle to the bottom.

If petitioners closed or sold a cafeteria, the drainage system would be left in the floor rather than moved

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to a new location. It would not be feasible to tear up the floors in order to get to the drains. If petitioners replace a piece of equipment for which the existing drain is not suitable, that drain would be blocked off and new drainage would be installed.

Electric Water Coolers.

The electric water coolers, located in the kitchen area of the cafeterias, provide cool drinking water solely to petitioners' employees during the day. The water coolers are not used by petitioners' cafeteria customers. The water coolers are connected to the fresh water supply system and kitchen drainage system by the use of standard plumbing connections. Water coolers, which are electrical-powered refrigeration units, chill the water prior to its use. Water coolers can be either wall-mounted or freestanding. In either case, the plumbing connections will be direct connections with the building's plumbing system. The wall-mounted water coolers are attached to and are supported by the wall framing by means of reinforced bracing or wall brackets concealed behind the finished wall surface.

The electric water coolers are provided to petitioners' employees in order to allow them to drink cool water without using water glasses which may break. In some geographic areas, petitioners are required by local health codes to provide electric water coolers for their employees.

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When petitioners move a cafeteria, the water coolers are moved to the new location.

Chandeliers, Decor Wall Lights, Dimmers and Installation.

Chandeliers are ceiling-hung light fixtures with a frame providing multiple lighting elements. A chandelier will generally be attached to a support bracket mounted to a structural portion of the ceiling. A single chain may be used to suspend the chandelier above the dining area. The chandelier will generally use bulbs with wattage ratings ranging from 15 watts to 25 watts, but the bulbs may range up to 40 watts. The chandelier wiring consists of direct wire connections to conjunction boxes installed in the ceilings. The wiring is then connected to the building's electrical system. When one of petitioners' cafeterias is remodeled every 5 years, the chandeliers are often changed or can be replaced by ceiling fans.

Decor wall lights are wall-mounted lights, mounted by bolting the fixtures to the finished walls. The wiring connections are concealed behind the base plates of the wall fixtures and behind the finished walls. Typically, the wall lights will be designed and coordinated to match the design of the chandeliers. The chandeliers and decor wall lights in issue provide from 5 percent to 40 percent of the available lighting in both the dining and kitchen areas of petitioners' cafeterias. The chandelier lights and wall

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lights are controlled by circuit breakers in the lighting panel box.

Dimmer switches are installed on the circuit wiring to the chandeliers and wall lights. The dimmer switches are variable rheostats that permit the cafeteria manager to vary the lighting intensity within the dining area as desired. The switches are mounted to the walls by screws and are placed directly over the outlet boxes for direct connection to the building's electrical system.

Kitchen Hot Water Heater.

The hot water heater in issue is a 300 or 400 gallon capacity tank with nickel, steel or glass lining that is insulated and receives either cold water or water that has been warmed and produces 140 or higher degree water. The hot water heater provides hot water for the kitchen appliances and equipment and in most cafeterias for both the employee and customer restrooms. However, less than 1 percent of the hot water used in petitioners' cafeterias is used in the public restrooms. The size of the hot water heater is based upon the amount of water that is being used in the sinks, the kitchen equipment and the dishwasher, per hour. The connection from the hot water heaters in issue to the various appliances and restrooms is through pipes located in the walls, ceiling or floor. A subsequent user of the building such as a retail establishment that did not

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use substantial amounts of hot water would have no use for the oversized water heaters in issue.

Primary Electrical Distribution System.

In petitioners' cafeterias, the portion of the electrical distribution system that brings in electricity from the outside source and feeds the electricity to the primary distribution point is referred to as the primary electric system. The primary electric system includes the wires and conduits from the outside power source, any transformer needed at this stage and the main distribution panel including the primary power switchgear.[5]

The secondary electric system in petitioners' restaurants distributes electricity from the main

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5 Petitioners did not claim investment tax credit for their primary electrical distribution system on their tax returns, but some have filed claims for refund claiming investment tax credit on the primary electrical distribution system. The investment tax credit for the primary electrical distribution system as claimed by petitioners are for the years and in the amounts as follows:

Name	Year Ending	Amount
Morrison Incorporated	May 28, 1977	$19,315
	June 3, 1978	31,415
Morrison of Woodland Hills	May 28, 1977	—
	June 3, 1978	40
Morrison of Tennessee	June 3, 1978	5,707
Morrison Cafeteria Co.	June 3, 1978	2,771
Morrison of Columbia, S.C.	June 3, 1978	6,458
Morrison of Jefferson Parish	May 31, 1976	11,963
	June 3, 1978	—
Morrison of Virginia	May 28, 1977	2,639
	June 3, 1978	—
Morrison of Savannah	May 28, 1977	2,462

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distribution panel to the kitchen equipment panels and the lighting panels. It includes the wiring and conduit (lighting panel feeder wires and kitchen panel feeder wires) from the main distribution panel to the subsidiary panels, and the subsidiary panels themselves, including the kitchen panel boards and the lighting panel boards. The consumptive devices in petitioners' restaurants are the ultimate users of electrical power. They include the wiring and conduit leading to those devices. The consumptive devices include lighting fixtures for the restaurant; kitchen equipment branch wiring (for which investment tax credit has already been allowed); kitchen appliance wiring (investment tax credit allowed); building service branch wiring for heating, ventilation and air conditioning equipment, receptacles, restrooms, cash registers, etc.; emergency lighting; yard lighting; and miscellaneous other electrical wiring and components.

The breakdown of costs attributable to the various components of the electrical distribution system are as follows:

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Electrical Distribution System Cost

Name	FY 1977	FY 1978	Total
Primary Electric			
Incoming Power Wiring	$ 16,331	$ 32,876	$ 49,207
Primary Power Switchgear	73,310	147,577	220,887
Secondary Electric			
Lighting Panel Feeder Wires	9,259	18,639	27,898
Kitchen Panel Feeder Wires	10,923	21,989	32,912
Lighting Panel Boards	22,142	44,574	66,716
Kitchen Panel Boards* K/K1/K2/K3	23,722	86,008	109,730
Consumptive Devices			
Building Service Branch Wiring (Includes Conduit Cost 75% of Total)	84,675	170,455	255,130
Kitchen Equipment Branch Wiring *	80,042	91,331	171,373
Lighting Fixtures	154,425	310,867	465,292
Miscellaneous Installations *			
(1) Emergency Lighting	36,351	57,099	93,450
(2) Chandelier Installation and Wall Decor Lights	5,397	4,026	9,423
(3) Miscellaneous Other Electrical Installation	98,846	148,060	246,906
Yard Lighting	57,798	116,350	174,148
Total Electrical Distribution System Costs	$673,221	$1,249,851	$1,923,072

*These figures differ from amounts in issue as stated on original stipulation because of elimination of amounts attributable to Goldsboro N.C. unit.

A study was conducted by Pennsylvania State University to measure the electrical consumption of seven typical food service operations including petitioners' Williamsburg, Virginia cafeteria. The study metered five basic areas of electrical consumption common to each of petitioners' cafeterias:

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1. Food preparation
2. Sanitation
3. Refrigeration
4. Lighting
5. Heating, ventilation and air conditioning

The percentages of all kilowatt hours of the electricity used by petitioners in their Williamsburg cafeterias attributable to the electrical consumption necessary to power machinery and equipment was 69.2 percent for the period studied.

The "load" on an electrical circuit is expressed in terms of voltage or kilovolt-amperes (kVA). A kilovolt-ampere is the voltage (in thousands) multiplied by the amperes of the circuit. The load of an electrical circuit is commonly considered to be the amount of electricity flowing through the circuit and is synonymous with power, or power demand. The loads on the electrical circuits in petitioners' cafeterias at issue and the division of the loads between circuits used to power machinery and equipment and circuits used to power the operation and maintenance function of the restaurant building measured as the percentage of the kilovolt-amperes load going into each of petitioners' restaurants is as follows:[6]

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[6] The percentages will change depending upon our determination of whether the kitchen air makeup unit qualifies for investment tax credit.

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Percentage of Load Applicable to Operation of Machinery and Equipment

Restaurant	With Kitchen Air Makeup Unit Not Qualifying For Credit	or	With Kitchen Air Makeup Unit Qualifying For Credit
FISCAL YEAR 1977			
Titusville, FL	62.5		64.4
Altamonte Springs, FL	53.6		55.1
Pinellas Square, FL	53.6		55.1
Lexington Mall, KY	41.6		42.9
Raceland Mall, KY	53.9		55.5
Tampa Bay Center, FL	53.6		55.1
Eastlake Square, Tampa, FL	48.5		49.9
Winterhaven, FL	53.6		55.1
Panama City, FL	55.8		57.4
Biloxi, MS	53.6		55.1
Albany, GA	41.4		42.7
FISCAL YEAR 1978			
Eastdale Mall, AL	65.8		67.7
Carbondale, IL	53.7		55.3
Whitehaven, TN	51.1		52.6
Coral Springs, FL	48.5		49.9
Sarasota, FL	59.0		60.8
Florence, KY	50.1		51.6
Naples, FL	53.0		54.5
Oaks Mall, FL	53.9		55.5
Vero Beach, FL	63.4		65.2
Owensboro, KY	51.7		53.3
Regency Square, FL	56.3		58.0
Winter Park, FL	64.7		66.6
Tupelo, MS	48.5		49.9
Metro Center, Jackson, MS	61.0		62.9
Hammond, LA	65.2		67.1
Columbia Mall, SC	56.6		58.3
Woodhill Center, SC	51.5		53.0
Williamsburg, VA	49.2		50.7

The electrical distribution system consists of standard electrical equipment that is purchased off the shelf from electrical equipment suppliers and is used in a wide variety of buildings. The electrical distribution

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system can be used and adapted to supply electricity to almost any type of electrical appliance or equipment. Since the electrical distribution system consists of components manufactured for general electrical use, a subsequent tenant in a similar food service business might be able to adapt the electrical distribution system in petitioners' cafeterias for his own use.

The electrical system leading to petitioners' cafeterias was more than adequate for the normal and customary stores or businesses that would be possible tenants for space in a building, shopping center or mall. Petitioners' cafeterias typically have 30 and 40 watts a square foot in electrical capacity whereas office space or shopping centers use only 15 watts a square foot.

During the years at issue in this case, petitioners constructed several cafeterias and equipped them with items for which they claimed investment tax credits on their tax returns.

In the notices of deficiency issued to petitioners for tax years ending May 28, 1977, and June 3, 1978, respondent disallowed petitioners' claim of investment tax credit on numerous items including the 19 items which remain in issue in this case with the explanation that the investment credit was claimed on property not constituting qualified section 38 property as defined in section 48 of the Code. In the notices of deficiency issued to Morrison

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Cafeteria of Jefferson Parish, Inc., and Morrison Food Services of Virginia, Inc., for tax year ending May 31, 1975, respondent disallowed petitioners' claim for carryback of investment credits from tax year ending May 31, 1978, to tax year ending May 31, 1975, with the explanation that all investment credit earned for tax year ending May 31, 1978, was allowed in that year. Petitioners in their petition also claimed investment tax credit on a portion of their primary electrical distribution system. No investment tax credit was claimed on the return for this item, but later petitioners filed claims for refund based on this item.

OPINION

Section 38 allows a credit against tax for investments in certain types of property, described as "section 38 property." In relevant part, section 48(a) states:

(a) Section 38 Property.--

(1) In general.--Except as provided in this subsection, the term "section 38 property" means--

(A) tangible personal property (other than an air conditioning or heating unit), or

(B) other tangible property (not including a building and its structural components) but only if such property--

(i) is used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, * * *

Tangible personal property is defined in section 1.48-1(c), Income Tax Regs., as follows:

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For purposes of this section, the term "tangible personal property" means any tangible property except land and improvements thereto, such as buildings or other inherently permanent structures (including items which are structural components of such buildings or structures). * * * Tangible personal property includes all property (other than structural components) which is contained in or attached to a building. * * *

A "structural component" of a building is ineligible for an investment tax credit and that term is defined in section 1.48-1(e)(2), Income Tax Regs., as follows:

(2) The term "structural components" includes such parts of a building as walls, partitions, floors, and ceilings, as well as any permanent coverings therefor such as panelling or tiling; windows and doors; all components (whether in, on, or adjacent to the building) of a central air conditioning or heating system, including motors, compressors, pipes and ducts; plumbing and plumbing fixtures, such as sinks and bathtubs; electric wiring and lighting fixtures; chimneys; stairs, escalators, and elevators, including all components thereof; sprinkler systems; fire excapes; and other components relating to the operation or maintenance of a building. However, the term "structural components" does not include machinery the sole justification for the installation of which is the fact that such machinery is required to meet temperature or humidity requirements which are essential for the operation of other machinery or the processing of materials or foodstuffs. Machinery may meet the "sole justification" test provided by the preceding sentence even though it incidentally provides for the comfort of employees, or serves, to an insubstantial degree, areas where such temperature or humidity requirements are not essential. For example, an air conditioning and humidification system installed in a textile plant in order to maintain the temperature or humidity within a narrow optimum range which is critical in processing particular types of yarn or cloth is not included within the term "structural components". * * * [Emphasis added.]

This Court has held that section 1.48-1(e)(2), Income Tax Regs., represents an accurate interpretation of Congressional intent and has the full force and effect of law. Piggly Wiggly Southern, Inc. v. Commissioner, 84 T.C. 739, 750 (1985), on appeal (11th Cir., Dec. 23, 1985); Fort

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Walton Square, Inc. v. Commissioner, 54 T.C. 653, 661 (1970).

Petitioners take the primary position that all the items in issue are tangible personal property within the meaning of section 1.48-1(c) of the Income Tax Regulations. Petitioners also contend that in any event all the items are "other tangible property" because they are used as an integral part of manufacturing or the production of food products.

Respondent contends that the various items in issue are not "tangible personal property" as defined in the regulations and that since petitioners were not engaged in manufacturing or production of food products but rather in the retail sale of such products, the provisions with respect to "other tangible property" are not applicable to them.

We will first address petitioners' contentions that they are in the business of manufacturing or production within the meaning of section 48(a)(1)(B), since this determination will affect the standard by which petitioners' claims to investment tax credit are judged.

In our view, petitioners' activity of operating cafeterias was a retail activity rather than a "manufacturing" or "production" activity within the meaning of section 48(a)(1)(B)(i). Section 1.48-1(d)(2), Income Tax Regs., provides that--

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"manufacturing", "production", and "extraction" include the construction, reconstruction, or making of property out of scrap, salvage, or junk material, as well as from new or raw material, by processing, manipulating, refining, or changing the form of an article, or by combining or assembling two or more articles, * * *. Thus, section 38 property would include * * * the processing of meat, fish, or other foodstuffs; * * *

As used in section 48(a)(1), the terms "manufacturing" and "production" are to be given their commonly accepted meaning. H. Rept. 1447, 87th Cong., 2d Sess., A18 (1962), 1962-3 C.B. 503, 516; S. Rept. 1881, 87th Cong., 2d Sess. 155 (1962), 1962-3 C.B. 843, 859.

Petitioners operated retail cafeterias and the preparation of food incidental to the retail sale of such food to the general public for consumption is not considered a manufacturing or producing activity. In Piggly Wiggly Southern, Inc. v. Commissioner, 84 T.C. 739, 749 (1985), on appeal (11th Cir., Dec. 23, 1985), we stated with respect to the taxpayer's claim that its preparation of meat for retail sale placed it in the business of manufacturing or production within the meaning of section 48(a)(1), as follows:

Activities involving the sale of merchandise and food to the general public for personal or household consumption and the rendering of services incidental to the sale of such goods are considered retail activities rather than manufacturing or producing activities. See Rev. Rul. 81-66, 1981-1 C.B. 19, 20. The meat prepared in petitioner's stores was for direct sale to and consumption by the general public. Thus, the preparation of meat was incidental to petitioner's retailing activities, and was not among the activities encompassed by section 48(a)(1)(B)(i).

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There is no distinction in petitioners' food preparation in the instant case and the taxpayer's meat preparation in the Piggly Wiggly Southern, Inc. case. Here, as in that case, petitioners' activities were not among those encompassed by section 48(a)(1)(B)(i).

Therefore, in this case our determination of whether petitioners are entitled to the claimed investment tax credits depends on whether the items are "tangible personal property" within the meaning of section 48(a)(1)(A).

As we pointed out in Whiteco Industries, Inc. v. Commissioner, 65 T.C. 664 (1975), tangible personal property is not to be narrowly defined or to necessarily follow the rules of State law. H. Rept. 1447, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 405, 415. Generally, all tangible property is tangible personal property unless it is excluded as land or an improvement thereto. In Whiteco Industries, Inc. v. Commissioner, supra at 672-673, we listed the following criteria for determining whether property is tangible personal property within the meaning of section 48(a)(1)(A):

> (1) Is the property capable of being moved, and has it in fact been moved? * * *
>
> (2) Is the property designed or constructed to remain permanently in place? * * *
>
> (3) Are there circumstances which tend to show the expected or intended length of affixation, i.e., are there circumstances which show that the property may or will have to be moved? * * *
>
> (4) How substantial a job is removal of the property and how time-consuming is it? Is it "readily removable"? * * *

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(5) How much damage will the property sustain upon its removal? * * *

(6) What is the manner of affixation of the property to the land? * * *

See Scott Paper Co. v. Commissioner, 74 T.C. 137, 170-172 (1980), which also discusses these questions in determining whether an item is tangible personal property for the purpose of the investment tax credit.

Under the criteria set forth above and bearing in mind that the term "tangible personal property" is not to be narrowly defined for purposes of section 48(a)(1)(A), whether the various items claimed by petitioners are tangible personal property is in each instance a factual determination.

Emergency Lighting.

Petitioners state that the primary purpose for the installation of the emergency lighting is to provide ample lighting for customers to finish their meals in the event of a power failure and to provide assurances that petitioners will be able to collect the amount owed by their customers. In petitioners' cafeterias, customers pay for their meals only after they have finished eating. Petitioners argue that the emergency lighting in issue is far in excess of that necessary for safety reasons in case of a power failure and serves only an incidental function of providing light for such safety requirements. Petitioners consider the emergency lighting as tangible personal property within the

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meaning of section 48(a) because it can be readily moved without any material damage to the premises.

Respondent argues that "lighting fixtures" are specifically mentioned as structural components in section 1.48-1(e)(2), Income Tax Regs. In addition, respondent argues that the emergency lighting relates to the operation or maintenance of the building and thus constitutes a structural component of the building.

In our view, petitioners' emergency lighting qualifies for the investment tax credit as tangible personal property because it meets many of the criteria for such property outlined in the Whiteco Industries case, supra. In the Senate Report accompanying the Revenue Act of 1962, S. Rept. 1881, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 707, 722, tangible personal property qualifying for the credit is stated to include "assets accessory to a business." The emergency lighting fixtures are distinguishable from lighting fixtures specifically mentioned in section 1.48-1(e)(2), Income Tax Regs., as constituting structural components of a building because these emergency fixtures do not provide basic illumination in the cafeterias. It is clear that lighting fixtures providing basic illumination in the cafeterias constitute structural components. However, the emergency lighting equipment serves a special function in petitioners' cafeterias where large numbers of people are served and must not only exit but finish eating and pay for

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their meals in the event of a power blackout. The emergency lighting enables petitioners to accomplish these objectives. The Senate Finance Committee Report for the 1978 Revenue Act (Pub. L. 95-600), S. Rept. 95-1263 (1978), 1978-3 C.B. (Vol. 1) 321, 415, provides as follows:

> In addition, the committee wishes to clarify present law by stating that tangible personal property already eligible for the investment tax credit includes special lighting (including lighting to illuminate the exterior of a building or store, but not lighting to illuminate parking areas) * * * [Emphasis added.]

In our view the emergency lighting qualifies as "special lighting." Consequently, emergency lighting is not a structural component of the building but instead is tangible personal property and as such qualifies for the investment credit.

Kitchen Panel Boards.

Petitioners contend that since the kitchen panel boards are necessary to and are used directly with specific items of machinery or equipment they are not structural components but constitute tangible personal property within the meaning of section 1.48-1(c), Income Tax Regs. Petitioners argue that the kitchen panel boards only serve petitioners' cafeteria kitchen equipment and machinery.

Respondent contends that the kitchen panel boards are part of the electrical wiring system of petitioners' cafeterias and are therefore specifically designated as structural components by section 1.48-1(e)(2), Income Tax

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Regs. Respondent argues that the panel boards are of standard electrical design rather than being specifically designed for use in petitioners' cafeterias. Respondent argues further that another tenant occupying the cafeteria could use the identical panel boards which have room for many circuits which can be changed simply by replacing the circuit breaker or installing a different electrical line to another appliance.

In our view the kitchen panel boards, which are merely holding devices for the circuit breakers that connect the electrical supply wires leading to the kitchen appliances, are necessary to and are used directly with specific items of kitchen machinery or equipment in petitioners' cafeterias. The kitchen panel boards in issue are thus distinguishable from the general equipment panel boards used to provide electricity to the remainder of the cafeteria. Central Citrus Co. v. Commissioner, 58 T.C. 365, 374 (1972); H. Rept. No. 1447, 87th Cong., 2d. Sess. (1962), 1962-3 C.B. 503, 516. Although the kitchen panel boards may be adaptable to other equipment, petitioners used the kitchen panel boards solely to accommodate the heavy duty equipment used in the kitchen. Therefore they are not structural components of the building but are essentially accessory to

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petitioners' business. S. Rept. 1881, 87th Cong., 2d. Sess. (1962), 1962-3 C.B. 707, 722.[7]

We conclude that the kitchen panel boards are eligible for the investment tax credit as tangible personal property because they constitute assets accessory to petitioners' business.

Kitchen Hand Sinks.

The kitchen hand sinks are necessary solely and exclusively because petitioners are engaged in food processing. Petitioners emphasize that the sinks are required by local codes to be located in the kitchen work areas in order to promote cleanliness by encouraging employees to wash their hands and are readily removable without any material damage to the premises. For these reasons, petitioners contend that the sinks constitute tangible personal property within the meaning of section 48(a)(1).

Respondent contends that the kitchen hand sinks are plumbing fixtures that relate to the operation or maintenance of the building within the meaning of section 1.48-1(e)(2), Income Tax Regs. Respondent emphasizes that the sinks may be adapted to other uses by petitioners. The sinks, respondent argues, are not unique to cafeterias but are commonly used in many businesses such as doctors' or

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7 Respondent allowed the investment tax credit with respect to the circuit breakers and wires directly leading to these appliances.

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dentists' offices. In addition, respondent argues that the sinks are designed to remain permanently in place as long as petitioners operate the cafeterias and therefore the sinks are structural components of the cafeterias.

The kitchen hand sinks do not function as specialized items of machinery or equipment even though the sinks are generally removed when a cafeteria is closed. They are bolted to the wall and connected to the plumbing system in a way to make removal difficult. These sinks are a part of the plumbing system. An application of the Whiteco Industries factors to this item indicates that the kitchen hand sinks, although solely serving the needs of petitioners' kitchen employees, were inherently permanent structures because they could be moved only with great difficulty, were designed to remain permanently in place, and were permanently attached to the plumbing in the cafeterias. We thus conclude that the kitchen hand sinks constitute structural components and do not qualify for the investment tax credit.

Kitchen Water Piping.

Petitioners claim that the kitchen water piping constitutes "other tangible property" because it is essential for the operation of specific pieces of petitioners' kitchen machinery and equipment and the preparation of foodstuffs. Petitioners emphasize that the removal of the kitchen water piping would not affect the

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cafeteria's main water piping and sanitary drainage and thus does not relate to the operation or maintenance of the building. In petitioners' view, the kitchen water piping is used as an integral part of petitioners' processing activities and is essential to the completeness of those activities.

Respondent contends that the kitchen water piping is part of the building's plumbing system and is thus a structural component within the meaning of section 1.48-1(e)(2), Income Tax Regs. Respondent emphasizes that the kitchen water piping is installed permanently below the cafeteria's concrete and tile floor and would be abandoned if petitioners closed a particular cafeteria. Respondent also emphasizes that the kitchen water piping could be adapted to general use and therefore could be used by a future tenant not operating a restaurant or cafeteria if petitioners vacated the building. Respondent also adds that petitioners could replace a piece of equipment and use the same water line to service the new equipment.

In Scott Paper Co. v. Commissioner, 74 T.C. 137, 183 (1980), we stated that items occurring in unusual circumstances that do not relate to the operation or maintenance of the building should not be considered as structural components even though specifically listed as such in section 1.48-1(e)(2) of the Income Tax Regulations. We there held the critical test to be whether the

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improvements related to the overall operation or maintenance of the building. It is clear that the cafeterias' kitchen water piping does not relate to general building plumbing which involves the operation or maintenance of petitioners' cafeterias. Instead, all the kitchen water piping in issue directly services petitioners' kitchen equipment and machinery.[8] We conclude that the kitchen water piping is necessary to and is used directly with specific pieces of petitioners' equipment and thus qualifies as section 38 property for investment tax credit purposes. Scott Paper Co. v. Commissioner, supra; section 1.48-1(e)(2), Income Tax Regs.

Eliason Doors.

According to petitioners, the Eliason doors which are special lightweight, double action doors installed to prevent accidents in the heavily trafficked area between the

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8 See Duaine v. Commissioner, T.C. Memo. 1985-39. A credit was allowed in Duaine for a restaurant's gas, plumbing and electrical fixtures that did not relate to general building services such as lighting, heating or ventilation. All the fixtures in issue directly serviced the taxpayer's equipment and machinery. Therein we also cited Rev. Rul. 66-299, 1966-2 C.B. 14, 16, which specifically states that--

> special electrical or plumbing connections which are necessary to and are used directly with a specific item of machinery or equipment, or between specific items of individual, machinery or equipment, are not structural components of the building, but are essentially items of machinery or equipment, and qualify as section 38 property for investment credit purposes.

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serving lines and the kitchen, do not serve a function merely as a front or rear door but are specially designed with a window to enable employees to move between the kitchen and the serving line without using their hands. Petitioners argue that the Eliason doors serve their specialized needs and are thus tangible personal property within the meaning of section 48(a)(1) because they are readily removable without any material damage to the premises.

Respondent argues that "doors" are specifically mentioned as "structural components" of a building in section 1.48-1(e)(2), Income Tax Regs. To support his position, respondent cites Consolidated Freightways, Inc. v. Commissioner, 708 F.2d 1385 (9th Cir. 1983), affg. in part and revg. in part, 74 T.C. 768 (1980), as well as Consolidated Freightways, Inc. v. United States, 620 F.2d 862 (Ct. Cl. 1980). Consolidated Freightways dealt with whether or not overhead doors in loading docks constituted structural components. This Court held that the overhead doors qualified for the tax credit but the Court of Appeals for the Ninth Circuit in construing the language in section 1.48-1(e)(2), Income Tax Regs., which includes "windows and doors" within the meaning of "structural components," held that the overhead doors did not qualify for the credit. The Ninth Circuit focused on a variety of factors including the function and design of the door, the intent of the taxpayer

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in installing the door, and the effect on the underlying building of the door's removal. The Ninth Circuit concluded that the overhead doors functioned as an integral part of the loading docks, were designed to be used as permanent features of the docks and that removal of the overhead doors would detract significantly from the usefulness of the docks in the taxpayer's operation. 708 F.2d at 1390. Thus, the Circuit Court concluded that the overhead doors constituted structural components and did not qualify for the investment tax credit.

The Eliason doors constitute a structural component only if they are a permanent part of the cafeteria building, so that their removal would affect the essential structure of the building. Sec. 1.48-1(e), Income Tax Regs. In the Senate report underlying the 1962 legislation, it is stated:

> . . .
>
> Tangible personal property is not intended to be defined narrowly here, nor to necessarily follow the rules of State law. It is intended that assets accessory to a business such as grocery store counters, printing presses, individual air-conditioning units, etc., even though fixtures under local law, are to qualify for the credit. Similarly, assets of a mechanical nature, even though located outside a building, such as gasoline pumps, are to qualify for the credit. * * * [S. Rept. 1881, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 707, 722.]

In our view the Eliason doors did not function as an integral part of the cafeterias and were not designed to be used as a permanent feature of the cafeterias. Removal of the doors would not detract significantly from the usefulness of the cafeterias because they have no more than an incidental relationship to the operation or maintenance

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of the building. The doors were necessary to assist petitioners in the operation of their cafeterias by providing their employees with easy and safe passage in and out of the kitchen area of the cafeterias. The record reflects that the doors were temporary attachments that could be removed easily and quickly. We conclude that the Eliason doors are not structural components of the cafeterias and thus qualify for the investment tax credit.

Restroom Accessories.

Petitioners contend that the restroom accessories constitute tangible personal property within the meaning of section 48(a)(1) because they are readily removable without any material damage to the premises. Petitioners argue further that a subsequent tenant would have no use for the items included in this claim because it is unlikely a subsequent tenant would be required to have the number of restroom facilities that are required in petitioners' business.

Respondent contends that the restroom accessories in issue are similar to those found in any public restroom and that these items relate to the operation or maintenance of the building rather than to petitioners' operation of a cafeteria. Respondent argues that all buildings open to the public must have restrooms and these restrooms usually include accessories like those in issue. These accessories, according to respondent, were not involved in an activity

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specifically related to the operation of a cafeteria. Respondent cites a District Court opinion from the Eastern District of North Carolina, A.C. Monk & Co. v. United States, No. 78-126-CIV-4 (E.D.N.C., March 30, 1981), affd. in part, revd. in part and remanded in part on another issue, 686 F.2d 1058 (4th Cir. 1982), on remand 52 AFTR 2d 83-6327, 83-2 USTC par. 9678) (E.D.N.C., Nov. 1, 1983). The taxpayer in Monk processed tobacco and claimed an investment tax credit for wall mirrors, towel dispensers and receptacles and similar items located in the factory and office lavatories. The court disallowed the taxpayer's claim and concluded that these items were intended to be permanent building fixtures.

In our view, the restroom facilities do not qualify for the credit because they are not an integral part of petitioners' business of operating a cafeteria. The accessories serve no function particularly unique to a cafeteria. The restroom accessories relate to the overall operation or maintenance of the building and as such are structural components. Scott Paper Co. v. Commissioner, supra at 186. Most buildings or facilities serving the public must have public restrooms and accompanying accessories similar to those at issue in this case. We conclude that the restroom accessories do not qualify for the credit.

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Decor Window Treatment.

Petitioners take the view that the decor window treatment serves purely a decorative function and is changed every 5 years in conjunction with other changes in petitioners' decorative plan. The window treatment, according to petitioners, does not serve a function relating to the operation or maintenance of the building because the simulated windows are impossible to see through and function merely as ornamentation. Removal of the decor wall treatment would not detract from the cafeterias's function, according to petitioners, and thus the decor window treatment constitutes tangible personal property.

Respondent argues that the decor window treatment was used as part of the permanent wall coverings and therefore is strictly defined as structural components in section 1.48-1(e)(2), Income Tax Regs.

We conclude that the decor wall treatment qualifies for the investment tax credit because it serves no more than an incidental relationship to the operation or maintenance of the building. The Senate stated in Report No. 95-1263:

> In addition, the committee wishes to clarify present law by stating that tangible personal property already eligible for the investment tax credit includes * * * false balconies and other exterior ornamentation that have no more than an incidental relationship to the operation or maintenance of a building, and identity symbols that identify or relate to a particular retail establishment or restaurant such as special materials attached to the exterior or interior of a building or store and signs (other than billboards). * * * [S. Rept. 95-1263 (1978) 1978-3 C.B. (Vol. 1) 321, 415. Emphasis added.]

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The decor window treatment served merely a decorative function in the cafeterias. It is changed approximately every 5 years in conjunction with the redecoration of the entire cafeteria. In our view, the window treatments do not contribute to the operation or maintenance of the building and thus constitute personal property eligible for the credit. Removal of the decor wall treatment would not damage the underlying wall. Any marks or holes left in the wall would be minimal.

Lattice Millwork.

Petitioners state that the lattice millwork is also a decorative item which is replaced every 5 years and does not relate to the operation or maintenance of the building. Petitioners contend that the lattice millwork constitutes readily removable tangible personal property.

Respondent argues that the lattice millwork is part of the permanent covering of the walls and thus constitutes structural components within the meaning of section 1.48-1(e)(2), Income Tax Regs.

As stated in Senate Report No. 95-1263, the lattice millwork has "no more than an incidental relationship to the operation or maintenance of a building." "Removable partitions, * * * which are attached to walls or suspended from the ceiling, are considered tangible personal property and not structural components." S. Rept. 95-1263 (1978), 1978-3 C.B. (Vol. 1) 321, 415. We conclude that the

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lattice millwork qualifies as personal property eligible for the investment tax credit. The lattice millwork is merely decorative ornamentation serving no more than an incidental relationship to the operation or maintenance of the building. Although the lattice millwork may be used to physically separate the serving line from the dining portions of the cafeteria, it does not serve as a structural support for the ceiling of the cafeteria. The lattice millwork could easily be removed without permanently damaging the underlying ceiling or walls and its removal would not entail great expense. The lattice millwork is tangible personal property qualifying for the investment tax credit.

Vanity Cabinets and Counters.

Petitioners state that they are required by local occupancy codes to install more restroom facilities such as vanity cabinets and counters than would be required in a building of the same size used for general purposes due to their business of serving large numbers of people at one time. Petitioners conclude that the vanity cabinets and counters are thus accessory to their business of operating a cafeteria.

Respondent contends that the counters and cabinets are attached permanently to the building because they are bolted to the wall. Respondent also argues that the vanity cabinets and counters could be used by any subsequent tenant

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occupying the cafeteria premises and do not relate specifically to petitioners' particular business. Respondent concludes that the vanity cabinets and counters were a necessary part of petitioners' public restrooms and are thus necessary in the operation or maintenance of the building within the meaning of section 1.48-1(e)(2), Income Tax Regs.

In our view the vanity cabinets and counters constitute structural components of the buildings and do not serve a function unique to petitioners' business. They are not accessory to petitioners' business of operating a cafeteria. The regulations specifically provide that "plumbing and plumbing fixtures, such as sinks and bathtubs" constitute structural components ineligible for the credit. The record reflects that the counters and cabinets were permanently attached to the walls of the restrooms and that removing them would damage the underlying walls. Whiteco Industries, Inc. v. Commissioner, supra.

Customer Line Screen.

Petitioners state that the customer line screen is designed to direct customers to the serving line. Petitioners argue that the line screen is not used as a wall separating rooms and supporting the ceiling but is a decorative partition required by petitioners' particular business needs. The line screen, according to petitioners, is integrally related to the line cafeteria concept and

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removal of the line screen would not in any way detract from the usefulness of the building but would impair petitioners' efficient control over the travel of customers in the cafeteria.

Respondent takes the view that the customer line screen is a structural component due to the inclusion of "walls" and "partitions" in the definition of structural components in section 1.48-1(e)(2), Income Tax Regs. Respondent focuses on the alleged permanent nature of the screen in issue and attempts to distinguish the customer line screens in issue from the movable partitions in Minot Federal Savings and Loan Assn. v. United States, 435 F.2d 1368 (8th Cir. 1970), and King Radio Corp., Inc. v. United States, 486 F.2d 1091 (10th Cir. 1973). In those cases investment tax credit was granted for partitions which could easily be moved and relocated without causing noticeable damage to the structure. The courts concluded that the movable partitions constituted tangible personal property rather than structural components of the taxpayers' buildings.[9]

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9 Respondent states that his position is supported by Mallinckrodt, Inc. v. Commissioner, T.C. Memo. 1984-532, affd. per curiam without published opinion (8th Cir. 1985), and Dixie Manor, Inc. v. United States, an unreported case (W.D. Ky. 1979, 47 AFTR 2d 81-1298, 79-2 USTC par. 9469), affd. without published opinion 652 F.2d 57 (6th Cir. 1981).

In Mallinckrodt, Inc, v. Commissioner, supra, we addressed whether gypsum drywall partitions used in office buildings qualified for the investment tax credit. The partitions divided the interior of the buildings into offices or utility space and were not capable of being

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Petitioners' customer line screen is similar to the movable partitions discussed in Minot Federal Savings and Loan Assn. and in King Radio Corp. The terms "walls" and "partitions" as used to define "structural components" in section 1.48-1(e)(2), Income Tax Regs., mean inherently permanent walls and partitions. Minot Federal Savings & Loan Assn. v. United States, 313 F. Supp. 294 (D. N.D. 1970), affd. 435 F.2d 1368 (8th Cir. 1970); King Radio Corp, Inc. v. United States, 486 F.2d 1091 (10th Cir. 1973).

The Senate Finance Committee, in its Report No. 95-1263 (1978), 1978-3 C.B. (Vol. 1) 321, 415, issued in connection with the enactment of the Revenue Rule Act of 1978, Pub. L. 95-600, 92 Stat. 2767, stated as follows:

> In addition, the committee wishes to clarify present law by stating that tangible personal property already eligible for the investment tax credit includes * * * movable and removable partitions * * *

(footnote continued from previous page)
removed or reused in their entirety or being stored as a unit. We concluded that the partitions were structural components due to their permanent nature. The facts in the Mallinckrodt case are totally distinguishable from those in the instant case.

In Dixie Manor, the Court addressed whether four partitions installed by a music company occupying space in a shopping center qualified as section 38 property. One of the items was drywall on wood studs, and some walls had paneled wainscoting and others were full-ceiling height in the restrooms. The District Court concluded that the partitions constituted structural components due to their permanent manner of attachment and the fact that the partitions were not readily movable. The facts in the Dixie Manor case are also distinguishable from the facts in the instant case.

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The customer line screen at issue in the instant case was a decorative partition separating the dining room from the cafeteria serving line and, like the movable partitions involved in Minot Federal Savings & Loan Assn. and King Radio Corp., was capable of being stored, sold or reused in its entirety.

We conclude that the customer line screens constitute personal property eligible for the investment tax credit.

Serving Line Concrete Curb.

Petitioners state that the purpose of designing and installing the serving line concrete curb was to prevent water from seeping into the customer side of the serving line and as such it is essentially part of the serving line equipment. Petitioners argue that the concrete curb aids essentially in cleaning which is not a function relating to the operation or maintenance of the building.

Respondent contends that the serving line concrete curb is permanently attached to the building and is constructed of brick or concrete blocks that are cemented or mortared to the floor and are covered with quarry tile. Moving the curb would be impractical according to respondent. Respondent notes that if petitioners closed a cafeteria, they left the

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serving line concrete curb and constructed another one at the new site.[10]

Applying the Whiteco Industries tests, we conclude that it would be impractical and expensive to move the curb due to its permanent nature. The concrete curb is a structural component of the building and not tangible personal property. We hold that the concrete curb is not eligible for the investment tax credit.

Kitchen Heat Recovery Unit.

Petitioners argue that the kitchen heat recovery unit is section 38 property because it constitutes "machinery the sole justification for the installation of which is the fact that such machinery is required to meet temperature * * * requirements which are essential for the operation of other machinery or the processing of * * * foodstuffs." Section 1.48-1(e)(2), Income Tax Regs. Petitioners contend that the kitchen heat recovery unit was installed solely because of the extensive hot water needs in their kitchens. Petitioners point out that any hot water supplied by the kitchen

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10 Respondent cites Duaine v. Commissioner, T.C. Memo. 1985-39, to support his position that the concrete curb constitutes a structural component ineligible for the credit.

In Duaine, the taxpayers claimed an investment tax credit for a portion of the Taco Bell restaurant's concrete foundation slab located behind the counter. We held in Duaine that the underlying concrete foundation slab, although slightly modified for design considerations, was clearly a structural component of the building.

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heat recovery unit to the remainder of the building is minimal.

Respondent contends that the heat recovery system is part of the building's plumbing system and is thus considered a structural component under section 1.48-1(e)(2), Income Tax Regs. Respondent also emphasizes that the method of installation of the heat recovery unit, with pipes running in the walls, floors, and ceiling of the cafeterias, renders it difficult to move. Respondent concludes that it is a permanent part of the plumbing system assisting in the operation or maintenance of the building.

Without consideration of the "sole justification" test, the heat recovery system, consisting of circulation pipes and tubing, might be considered to constitute part of the plumbing system of petitioners' cafeterias and thus constitute a structural component. However, in Piggly Wiggly Southern, Inc. v. Commissioner, 84 T.C. 739, 753 (1985), on appeal (11th Cir., Dec. 23, 1985), we held that items that might otherwise constitute structural components of a building are tangible personal property within the meaning of section 48(a)(1)(A) if the sole justification for their installation is to assist in the operation of the taxpayer's equipment. We conclude that petitioners' sole justification for the installation of the kitchen heat recovery system was that the system was essential to meet the hot water needs of petitioners' cafeterias in a cost

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effective manner. Thus, we find that pursuant to section 1.48-1(e)(2), Income Tax Regs., petitioners' heat recovery unit meets the exception to the term "structural components." Section 1.48-1(e)(2), Income Tax Regs., defines structural component to include all components of a heating system including motors, compressors, pipes, ducts, plumbing and plumbing fixtures unless the "sole justification" test is met. When systems meet the sole justification test and are thus not structural components, they are considered property in the nature of machinery without regard to their inherent permanence. Piggly Wiggly Southern, Inc. v. Commissioner, supra at 753.

Cooler, Freezer and Garbage Room Floors and the Garbage Room.

Petitioners contend that the cooler, freezer and garbage room floors which have more insulation than floors in the remaining portions of the cafeteria, were designed and installed to function as items of machinery and thus constitute tangible personal property.

Respondent states that the cooler, freezer and garbage room floors were the same as the floors in the remaining portions of the kitchen area, except that they were elevated approximately 5/8 inch above the remaining floors and had 4 inches of insulation and 4 inches of concrete beneath them

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which did not exist under other floors in the cafeteria.[11] Respondent also argues that floors are specifically defined as being structural components in section 1.48-1(e)(2), Income Tax Regs. Respondent emphasizes that the floors in issue could not be moved to another location without great expense, difficulty and damage to the underlying structure and thus were permanent additions to the building.

Structural components are defined in the regulations to include "floors." Section 1.48-1(e)(2), Income Tax Regs. To support their conclusion that the "sole justification" language applies to exclude their floors from the definition of structural components, petitioners have failed to note that the "sole justification" language applies only to "machinery" essential for the operation of other machinery or the processing of foodstuffs. Section 1.48-1(e)(2), Income Tax Regs. Floors do not constitute machinery and thus do not fit into this exception.

Although the floors in issue may differ somewhat from the floors in the remaining portions of the cafeteria due to the fact that they are built on extra insulation, they nevertheless are floors. We consider them to be structural components due to the permanent nature in which they are

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11 Respondent relies on Duaine v. Commissioner, T.C. Memo. 1985-39, in which we held that wall and floor tiles in the taxpayer's restaurant food preparation, refrigeration, storage and loading areas constituted a permanent covering for the restaurant's walls and floors and hence constituted structural components ineligible for the investment tax credit.

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installed. It would be difficult to remove them and removal would damage the underlying foundation.

Senate Report No. 95-1263 states as follows with respect to floors:

> Similarly, floor coverings which are not an integral part of the floor itself such as floor tile generally installed in a manner to be readily removed (that is it is not cemented, mudded, or otherwise permanently affixed to the building floor but, instead, has adhesives applied which are designed to ease its removal) * * * are considered tangible personal property and not structural components. * * * [S. Rept. 95-1263 (1978), 1978-3 C.B. (Vol. 1) 321, 415.]

The cooler, freezer and garbage room floors here in issue could not be removed without substantial damage to the building and therefore constitute structural components of the cafeterias.

We next consider whether the garbage room constitutes section 38 property. Petitioners maintain that the garbage room constitutes "other tangible property" used as an integral part of manufacturing or production under section 48(a)(1)(B)(i) and, therefore, qualifies as section 38 property. As previously discussed, section 48(a)(1)(B) is not applicable to petitioners since they were not engaged in manufacturing or production. Petitioners also argue that the garbage room, which is a refrigerated room consisting of concrete blocks and insulation panels applied to the interior wall and ceiling surfaces, is necessary to meet health code requirements by inhibiting the contamination of food waste in the garbage room prior to pickup of the

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garbage. Petitioners argue that the refrigerated garbage rooms are not a building or a part thereof within the meaning of section 1.48-1(e)(1), Income Tax Regs. Petitioners argue that the refrigerated garbage rooms are integral to petitioners' food service activities. Petitioners cite Giannini Packing Corp. v. Commissioner, 83 T.C. 526 (1984), appeal dismissed (9th Cir. June 10, 1985), to support their conclusion that the refrigerated garbage rooms are an integral part of petitioners' production activities and therefore constitute eligible section 38 property. In Giannini, supra, the taxpayer was engaged in the business of acquiring, processing, storing, and marketing fresh fruit and claimed an investment tax credit for the structural elements of two holding rooms in its packing plant. Concluding that cooling the fruit was one of the most important aspects of the taxpayer's fruit processing activities, we held that the holding rooms were an integral part of the taxpayer's production of fresh fruit and were "essential to the completeness of the activity" within the meaning of section 1.48-1(d)(4), Income Tax Regs., which defines when property is used as an "integral part" of "production." Section 1.48-1(d)(2), Income Tax Regs. Giannini Packing Corp. v. Commissioner, supra at 532. The Giannini Packing Corp. case deals with a taxpayer involved in processing fruits and is not applicable to petitioners.

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Respondent argues that the garbage room is part of the building itself and therefore not tangible personal property. Respondent emphasizes that the garbage room has walls, a floor, a ceiling, provides shelter, as well as a working space, and is thus part of the cafeteria building within the meaning of section 1.48-1(e)(1), Income Tax Regs.[12] In order to qualify as section 38 property, the garbage rooms must be shown to be tangible personal property under section 48(a)(1)(A). Due to the permanent nature of the garbage rooms and the inability of petitioners to physically move the room without great difficulty, expense and damage to the underlying building, we conclude it constitutes an inherently permanent structural component of the cafeteria within the meaning of section 1.48-1(e)(2), Income Tax Regs., and is ineligible for the investment tax credit.

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Respondent cites Circle K Corp. v. Commissioner, T.C. Memo. 1982-298, in which this Court held that a cold storage room constructed to store ice in an ice manufacturing plant constituted a building and did not qualify for the credit.

In Circle K. Corp., the taxpayer operated an ice manufacturing plant and constructed an addition which was a cold storage room. We held that the taxpayer was not entitled to the investment tax credit on this cold storage room because of its failure to prove that it was necessary to place the ice in a cold storage room for 24 hours in order to complete the manufacturing process. This proof was necessary to show that cold storage of the ice for a 24-hour period was an integral part of the manufacturing process as required in section 1.48-1(d)(4), Income Tax Regs.

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Kitchen Sanitary Wall and Floor Tiles.

Petitioners claim that the kitchen wall and floor tiles are eligible for the credit because their cafeterias are required by local codes to have readily cleanable surfaces in order to maintain sterile and sanitary conditions and inhibit bacterial growth. Petitioners argue that the sanitary wall and floor tiles serve a business function particularly suited to their food processing operation and that the sanitary wall and floor tiles do not relate to the operation or maintenance of the building. Petitioners further argue that the removal of the floor and wall tiling would in no way alter the operation of a building because many buildings function with exposed concrete block, brick or painted surfaces.

Respondent contends that "tiling" is specifically defined as a structural component in section 1.48-1(e)(2), Income Tax Regs.[13] Respondent argues that the tile used on the walls and floors is not unique to a cafeteria but is used in the public areas of many businesses. Respondent also notes that the wall and floor tile are permanently attached by mortar cement and a grout mixture which, after drying permanently, attaches the tiles to the surfaces.

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13 Respondent again cites Duaine v. Commissioner, T.C. Memo. 1985-39, to support his position. In that case we held that the wall and floor tiles in the food preparation, refrigeration, storage and loading areas of a restaurant constituted structural components of the building because the tiles are permanently glued to the restaurant's walls and floors.

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We agree with respondent that the kitchen wall and floor tiles constitute structural components of the cafeterias due to their permanent attachment by means of mortar or grout. In addition, the tiles are specifically mentioned as structural components in section 1.48-1(e)(2), Income Tax Regs., and Senate Report No. 95-1263 specifically states that floor tile, that is cemented, mudded, or permanently affixed to the building floor, constitutes a structural component ineligible for the investment tax credit. The only floor tile eligible for the credit according to the Senate Report is tile that has been applied by adhesives which are designed to ease its removal. S. Rept. 95-1263 (1978), 1978-3 C.B. (Vol. 1) 321, 415.

Kitchen Air Makeup Unit.

Petitioners take the view that the kitchen air makeup unit aids them in satisfying ventilation requirements which are essential to the processing of foodstuffs in petitioners' cafeterias. Petitioners argue that the kitchen air makeup unit is analogous to the HVAC units in Piggly Wiggly Southern Inc. v. Commissioner, 84 T.C. 739 (1985), on appeal (11th Cir., Dec. 23, 1985), in which this Court held that the HVAC units qualified as section 38 property because their sole justification was meeting the temperature and humidity requirements essential to the operation of refrigeration equipment in the taxpayer's supermarkets. Petitioners emphasize that the purpose of the kitchen air

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makeup unit is not to provide the ventilation system for the kitchen but to replace air which must be exhausted and therefore the unit in issue does not function as an air conditioning system. Petitioners further contend that the kitchen air makeup unit is an integral part of their food processing operation and that a subsequent tenant would have no use for this system unless that tenant was engaged in the same business.

Respondent contends that the kitchen air makeup unit substitutes for a ventilation system in petitioners' cafeterias and therefore is a structural component within the meaning of section 1.48-1(e)(2), Income Tax Regs. Respondent emphasizes that the kitchen air makeup unit brings in fresh air to the kitchen, is the only source of fresh air to the kitchen and therefore is a ventilation system relating to the operation or maintenance of the building. Respondent also argues that petitioners intended the kitchen air makeup units to be permanently attached to the building and that they were designed to remain permanently in place during the life of the building. Respondent relies on Kramertown Co. v. Commissioner, 488 F.2d 728 (5th Cir. 1974), affg. a Memorandum Opinion of this Court, in which the taxpayer's rooftop air conditioning and heating units were held ineligible for the credit because the taxpayer intended the equipment to remain in place

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permanently. For this reason, it was held that the equipment constituted a structural component.

The purpose of the kitchen air makeup unit is to replace the 24,000 cubic feet per minute of air that is exhausted from the kitchen with filtered outside air via ducts in ceiling outlets. In our view the kitchen air makeup unit is analogous to the HVAC units that the taxpayer in Piggly Wiggly Southern installed in its supermarkets which we concluded were not structural components because "the sole justification for the installation of the HVAC units was the necessity to meet the temperature and humidity requirements of the refrigeration equipment in [the taxpayer's] stores." 84 T.C. at 751. We stated therein that without consideration of the sole justification test, the HVAC units installed by the taxpayer would have constituted structural components as defined in section 1.48-1(e)(2), Income Tax Regs. 84 T.C. at 751. This Court distinguished the shopping centers' roof top air-conditioning and heating systems in Fort Walton Square, Inc. v. Commissioner, 54 T.C. 653 (1970), and in Kramertown Co. v. Commissioner, supra. In both cases the rooftop air conditioners constituted structural components because the purpose of the systems in the shopping centers was customer convenience and the taxpayers failed to establish that the systems were essential to the operation of the taxpayer's machinery. In Piggly Wiggly Southern, however, the HVAC

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units were not structural components because they were essential to the operation of the refrigerator cases in the taxpayer's supermarkets.

Here, as in the Piggly Wiggly Southern case, without consideration of the "sole justification" test the kitchen air makeup unit would constitute a structural component. However, the evidence presented by petitioners clearly establishes that the sole justification for the installation of the kitchen air makeup unit was to maintain specific ventilation requirements esential for operation of petitioners' kitchen equipment. The unit qualifies as tangible personal property in the nature of machinery rather than a structural component[14] because it is installed only to meet temperature or humidity requirements that are essential for the operation of petitioners' other kitchen equipment. Section 1.48-1(e)(2), Income Tax Regs.

Respondent's contention that petitioners' air makeup unit substituted for a ventilation system in the cafeterias is not supported by the evidence.

Kitchen Drainage.

Petitioners contend that the kitchen drainage constitutes tangible personal property because it was used as an integral part of their cafeteria operation and thus

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14 See Rev. Rul. 81-240, 1981-2 C.B. 11; Rev. Rul. 75-77, 1975-1 C.B. 7.

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does not relate to the operation or maintenance of their cafeteria buildings.

Respondent contends that the kitchen drainage system was a part of the building's plumbing system within the ordinary meaning of that word and that "plumbing and plumbing fixtures" are specifically defined as structural components in section 1.48-1(e)(2), Income Tax Regs. Respondent emphasizes that there were two purposes for the drainage system: (1) to drain wash water that was used to wash and clean the cafeteria walls and floors; and (2) to drain waste water and other liquid waste produced in the food preparation process and lead these wastes to a grease trap in which grease and other food particles were separated from the water before it flowed into the sanitary sewer system. The drainage of the food preparation wastes was accomplished through the use of hub drains which were open air drains that did not allow waste to be siphoned back into the equipment and the kitchen wash water was drained through floor drains. Respondent also emphasizes that the installation of the kitchen drainage system was permanent because the system was either buried beneath the cafeteria slab floors, behind the finished walls, or was buried in the ground outside of the cafeteria. Respondent cites Everhart v. Commissioner, 61 T.C. 328 (1973), to support his argument. In Everhart, this Court held that a sewage disposal system constituted an inherently permanent

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structure even though it was a self-contained prefabricated unit. This Court based its decision on the system's permanent affixation to the land. 61 T.C. at 331.

We find the sewage disposal system in Everhart to be distinguishable from the kitchen drainage at issue in the instant case. In Everhart, the taxpayer excavated an area for the sewage disposal tank and put in a concrete foundation. The tank was then lowered into the excavation and anchored to that foundation. After connecting the sewage pipes, the excavation was refilled and the area was enclosed by a chain link fence. The system in Everhart did not serve any specific needs of the taxpayer's laundromat business but related more to the operation or maintenance of the entire shopping center where the laundromat was located. We do not find respondent's analogy to this sewage system to be persuasive.[15]

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Respondent attempts to distinguish Duaine v. Commissioner, T.C. Memo. 1985-39, in which we held the connectors between the taxpayer's restaurant equipment and the drainage system to be tangible personal property. The drainage system itself was not at issue in Duaine. In Duaine, the taxpayers claimed an investment tax credit for the plumbing and gas fixtures connecting the Taco Bell restaurant equipment to incoming utility "stub-outs," electrical outlets and conduit providing localized power sources for their equipment, the drain line connecting the taxpayers' refrigerators and sinks to the building drains, and the water lines providing water from the water mains to steam trays, cooking vessels and ice machines. In Duaine, we applied the test from Scott Paper Co. v. Commissioner, 74 T.C. 137 (1980), and concluded that the restaurant's gas, plumbing and electrical fixtures did not relate to general building services such as lighting, heating and ventilation, which involved the operation or maintenance of a building

(footnote continued)

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In our view petitioners' kitchen drainage system from the point the connecting devices couple to the drainage system is analogous to the electric wiring in Scott Paper Co. v. Commmissioner, supra. We recognize that structural components are defined in section 1.48-1(e)(2), Income Tax Regs., to specifically include "plumbing and plumbing fixtures, such as sinks and bathtubs; electric wiring and lighting fixtures * * *." Although we give great weight to respondent's regulations, we do not read the words "plumbing and plumbing fixtures" in a vacuum just as we did not read the words "electric wiring" in a vacuum in Scott Paper Co. v. Commissioner, supra at 183. We interpret the phrase of section 1.48-1(e)(2), Income Tax Regs., which reads "and other components relating to the operation or maintenance of a building" to be a "descriptive phrase intended to present the basic test used for identifying structural components." Scott Paper Co. v. Commissioner, supra at 183. As we stated in Scott Paper Co. v. Commissioner, supra at 183, "[i]tems which occur in an unusual circumstance and do not relate to the operation or maintenance of a building should not be structural components despite being listed in section 1.48-1(e)(2), Income Tax Regs."

(footnote continued from previous page)
but to the operation of the taxpayers' equipment and machinery. Respondent attempts to distinguish Duaine on the ground that the drainage system itself was not at issue in that case. We do not agree with respondent that the Duaine case is distinguishable from the instant case with respect to the drains.

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We focus on petitioners' use of the drains in the kitchen and conclude that they do not relate to the general drainage of waste from the building but rather, drain wastes resulting from petitioners' food preparation activities. Despite the apparent character of the kitchen drainage as a permanent plumbing fixture, we conclude that it actually services petitioners' equipment and machinery[16] and is thus eligible for the credit as section 38 property.

Electric Water Coolers.

Petitioners contend that they are entitled to the credit on the electric water coolers because the primary purpose of the coolers was to prevent employees from using glasses in the kitchen area where the risk of broken glass falling into the food would create a significant hazard. Petitioners argue that the water coolers do not serve a function relating to the operation or maintenance of the building.

Respondent argues that the electric water coolers provided water for petitioners' employees and were thus part of the building's overall plumbing system. Respondent argues that the water coolers related to the operation or maintenance of the building within the meaning of section 1.48-1(e)(2), Income Tax Regs. Respondent also emphasizes the permanent manner in which the water coolers were attached to the kitchen walls by brackets and bolts.

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16 See Rev. Rul. 66-299, 1966-2 C.B. 14.

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We agree with respondent and conclude that water coolers constitute structural components because they are "plumbing and plumbing fixtures" which are structural components as defined in section 1.48-1(e)(2), Income Tax Regs. Petitioners' water coolers are permanently attached to the walls and do not service any of their specific machinery or equipment or provide an unusual service unique to petitioners' needs but rather relate to the operation or maintenance of the building.

Chandeliers, Decor Wall Lights, Dimmers and Installation.

Petitioners contend that the chandeliers and decor wall lights were installed only for decorative purposes and they did not exist to provide general room illumination as there was ample lighting throughout the cafeteria for such purpose. Petitioners conclude that the decorative lighting was not intended to and did not relate to the operation or maintenance of the building.

Respondent contends that the "lighting fixtures" in a building are specifically defined in section 1.48-1(e)(2), Income Tax Regs., as being a structural component of a building. Respondent relies on Consolidated Freightways, Inc. v. Commissioner, 708 F.2d 1385 (9th Cir. 1983), affg. in part and revg. in part 74 T.C. 768 (1980), in which it was held that lighting fixtures were structural components

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of a building.[17] In Consolidated Freightways, Inc. v. Commissioner, 708 F.2d at 1390, the Court of Appeals for the Ninth Circuit reversed our determination that certain lighting fixtures were eligible for the investment tax credit. The Circuit Court concluded that the lighting fixtures in Consolidated Freightways functioned as an integral part of the taxpayer's loading docks and were designed to be a permanent feature of the docks. The Ninth Circuit emphasized that removal of the overhead doors and lighting fixtures would detract significantly from the usefulness of the docks in the taxpayer's operations. There was no argument in Consolidated Freightways that the lights on the taxpayer's truck loading docks were decorative

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17 Respondent also relies on Duaine v. Commissioner, T.C. Memo. 1985-39, in which the taxpayer claimed an investment tax credit for the interior and exterior ornamental light fixtures of the Taco Bell restaurant. We held in Duaine that the taxpayer's contention that the ornamental lighting fixtures were purely decorative was not supported by the record and we concluded that the interior and exterior lighting fixtures provided the only artificial lumination in the customer eating area and along the walkways to the buildings. We held that the interior and exterior lighting fixtures constituted structural components of the restaurant and related to the operation or maintenance of the building housing the restaurant. We stated that the ability of the restaurant's designer to camouflage the standard lighting requirements by incorporating the restaurant's motif into their appearance did not warrant a contrary conclusion.

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lighting fixtures and we consider this fact to distinguish that case from the instant case.[18]

The chandeliers and decor wall lights used in petitioners' cafeterias were purely decorative fixtures which were designed specifically to compliment petitioners' decorative motif in specific cafeterias. The chandeliers and decor wall lights in issue used low wattage of 15 watt bulbs as compared to 150 or 75 watt bulbs which were used for the recessed lighting fixtures which are not at issue in this case. As stated in Senate Report No. 95-1263, "tangible personal property already eligible for the investment credit includes special lighting (including lighting to illuminate the exterior of a building or store, but not lighting to illuminate parking areas) * * *." 1978-3 C.B. (Vol. 1) at 415.

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18 In Shoney's South, Inc. v. Commissioner, T.C. Memo. 1984-413, this Court held that chandeliers and hanging lanterns used in the taxpayer's restaurant did not relate to the operation or maintenance of the building but were designed specifically for decorative use in the restaurant and enhanced its atmosphere. The chandeliers could be removed from one location and shipped to another if needed. Removal did not damage the chandeliers or lanterns. They were replaced on the average of every 5 to 7 years either in connection with general remodeling or with installation of new salad or breakfast bars. After applying the permanency test of Whiteco Industries, Inc. v. Commissioner, 65 T.C. 664, 672-673 (1975), we concluded that the chandeliers and lanterns were not reasonably permanent and that they were assets accessory to the taxpayer's business, S. Rept. 1881, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 707, 722, rather than components relating to the operation or maintenance of the building in which they were located. Petitioners' chandeliers and decor wall lights serve the same function as those in Shoney's South.

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We conclude that the chandeliers, decor wall lights, and dimmers constitute section 38 property because they constitute "special lighting," are assets accessory to petitioners' business, are readily movable and do not relate to the operation or maintenance of the building. The chandeliers and decor wall lights in issue were not the major source of light in the cafeteria and merely incorporated petitioners' decorative motif and complimented the interior design of its cafeterias.

Petitioners are not entitled to a credit for installation of the chandeliers, decor wall lights or dimmers because installation is not "tangible personal property" or "other tangible property."

Kitchen Hot Water Heater.

Petitioners contend that the hot water heater is "machinery the sole justification for the installation of which is the fact that such machinery is required to meet temperature * * * requirements which are essential for the operation of other machinery or the processing of * * * foodstuffs." Section 1.48-1(e)(2), Income Tax Regs. Petitioners argue that the hot water heater was installed solely because of the extensive hot water needs in the cafeterias. Petitioners argue that the hot water heater functions solely to supply the needs of their equipment and machinery in the cafeteria kitchens.

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Respondent contends that the hot water heater is an integral part of the building's plumbing system because it provides hot water for the kitchen operations as well as for the public and employee restrooms. Thus respondent concludes that the hot water heater functions in the operation or maintenance of the building and thus is a structural component within the meaning of section 1.48-1(e)(2), Income Tax Regs. Respondent also contends that the hot water heater could be used by other tenants who may replace petitioners because the heater is adaptable to uses other than providing water for petitioners' kitchen operations. In addition, respondent notes that the hot water heater is connected to the plumbing system of the building through piping and is thus intended to remain permanently in place during the entire life of the cafeteria.

In our view petitioners' sole justification for the installation of a kitchen hot water heater with a 300 or 400-gallon capacity was to meet the extensive hot water requirement for the operation of their kitchen machinery or equipment. Thus, we find that pursuant to section 1.48-1(e)(2), Income Tax Regs., petitioners' kitchen hot water heater meets the exception to the term "structural component" without further consideration of the inherent permanence test as established in Whiteco Industries.

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Piggly Wiggly Southern, Inc. v. Commissioner, 84 T.C. 739, 753 (1985), on appeal (11th Cir., Dec. 23, 1985).

Primary Electrical Distribution System.

Petitioners filed claims for refunds claiming an investment tax credit for the percentage of the cost of the cafeterias' primary electrical distribution system they consider allocable to the service of cafeteria-related machinery and equipment. Petitioners determined the eligible percentage by measuring the electrical consumption in watts or kilowatts at the Williamsburg, Virginia, cafeteria. They determined that the percentage of kilowatt hours attributable to the electrical consumption necessary to power eligible machinery and equipment was 69.2 percent. They applied this percentage to the total electrical costs of $1,923,072 to arrive at a claim for investment tax credit of $1,330,766. From this figure, they subtracted the amount previously claimed of $630,882 to arrive at an additional amount claimed of $699,884.[19]

Petitioners support their allocation of the electrical distribution system between the structural and processing-related functions on the basis of consumption of electrical power by citing Scott Paper Co. v. Commissioner, 74 T.C. 137 (1980). In Scott Paper Co., we concluded that the

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19 Petitioners add that if we determine that the kitchen panel boards are eligible for the credit, then the cost attributable to the kitchen panel boards will be subtracted from the cost of the secondary electric before the 69.2 percent is applied.

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components of the taxpayer's primary electric system which supplied the electric needs of process machinery rather than contributing to the overall operation or maintenance of buildings, was not an inherently permanent structure and the taxpayers were entitled to the investment tax credit on these components. In reaching this conclusion we placed great emphasis on the language in section 1.48-1(e)(2), Income Tax Regs., which defines "structural components" by listing examples and including as the last line of the regulation "and other components relating to the operation or maintenance of a building." In Scott Paper Co., supra at 183, we characterized that phrase as follows:

> a descriptive phrase intended to present the basic test used for identifying structural components. The preceding elements are examples of items which meet that test as a general rule. Items which occur in an unusual circumstance and do not relate to the operation or maintenance of a building should not be structural components despite being listed in section 1.48-1(e)(2), Income Tax Regs. * * *

We also quoted the Technical Explanations of the Revenue Act of 1962 which explained the language which was incorporated in the regulation as follows:

> The term "structural components" of a building includes such parts of the building as central air-conditioning and heating systems, plumbing, and electric wiring and lighting fixtures, relating to the operation [or] maintenance of the building. [H. Rept. 1447, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 503, 516; S. Rept. 1881, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 843, 859.]

In accordance, we concluded that property fails to qualify for the credit if it relates to the overall operation or

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maintenance of a building rather than being used to aid in the employment of a particular function or particular piece of property. See Central Citrus Co. v. Commissioner, 58 T.C. 365, 374 (1972).

We focused on the ultimate uses of power at the taxpayer's facility in Scott Paper Co. and distinguished the power used in the overall operation or maintenance such as lighting, heating, ventilation and air-conditioning of the building and the power used to operate the taxpayer's machinery. Scott Paper Co. v. Commissioner, supra at 183-184. We thus concluded in Scott Paper Co. that:

> To the extent that the primary electric carried electrical loads to be used for pulp and paper production processes or other such qualifying uses, the investment credit will be allowed for the primary electric improvements.
>
> To the extent that the primary electric improvements relate to the overall operation [or] maintenance of buildings, they are structural components of such buildings, and they do not qualify as tangible personal property. Central Citrus Co. v. Commissioner, 58 T.C. 365 (1972); Ponderosa Mouldings, Inc. v. Commissioner, 53 T.C. 92 (1969); sec. 1.48-1(c), Income Tax Regs. * * * [Scott Paper Co. v. Commissioner, supra at 186. Emphasis added.]

Petitioners state that the investment tax credit was claimed only on the portion of the primary electrical distribution system which is directly applicable to the operation of the machinery and equipment. Petitioners also add that subsequent tenants would have very little use for an electrical distribution system with 5 to 10 times the capacity that would be required for the operation or maintenance of a general purpose building.

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Respondent disallowed petitioners' claims for refund for the entire primary electrical distribution system of the cafeterias with the explanation that the system was a structural component of the buildings.[20] Respondent argues in the alternative, however, that if an allocation is made by this Court, petitioners' calculation of the amount eligible for the credit based on consumption is incorrect because the proper way to measure the electrical distribution system is on the basis of electrical load which is measured in terms of kilovolt-amperes. In respondent's view, electrical load directly relates to the cost of all other components of the system and is the primary means of measuring the capacity of a system.

Respondent takes the view that the electrical distribution systems constitute structural components of petitioners' cafeterias within the meaning of section 1.48-1(e)(2), Income Tax Regs.[21] Respondent adds that these systems are reasonably adaptable to other uses by

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20 Respondent did not disallow the credit claimed in the tax returns for the part of the electrical distribution system that connects directly to petitioners' kitchen machinery and equipment. This includes the cost of the wiring, conduit and circuit breakers by which the machinery and equipment is actually connected to the electrical distribution system.

21 Respondent states on brief that if an allocation is made, a credit should only be allowed for the primary electric because it serves a dual function--the operation or maintenance of the building and the operation of the machinery and equipment.

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petitioners or subsequent tenants and would not have to be replaced if the building was used for another activity. Respondent argues that section 1.48-1(e)(2), Income Tax Regs., specifically includes "electric wiring" in the definition of structural components. Respondent also cites Senate Report 1881, 87th Cong., 2d. Sess. 155 (1962), 1962-3 C.B. 703, 859, wherein structural components were defined to include electric wiring relating to the operation or maintenance of the building.

Respondent also disputes the allocation of the electrical distribution system between qualifying and nonqualifying uses of the electrical power. Respondent cites A.C. Monk & Co. v. United States, 686 F.2d 1058 (4th Cir. 1982), to support his position.[22] Respondent argues that to the extent that Scott Paper Co. v. Commissioner, 74 T.C. 137 (1980), held that a portion of the building's primary electrical system was allocable between qualifying and nonqualifying property, that case was in error. Specifically, respondent disagrees with the part of this Court's opinion in Scott Paper Co. wherein we determined a

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22 The Fourth Circuit in A.C. Monk & Co. v. United States, 686 F.2d 1058 (4th Cir. 1982), held that the proper approach is to determine whether the electrical system has more general uses than special uses for operating items of machinery and, if so, the system is a structural component of the business and hence nonqualifying. Any appeal in this case will lie in the Eleventh Circuit, so we need not reexamine our holding in the Scott Paper Co. case at this time.

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percentage use of the primary electrical distribution system for operation or maintenance of the building and a percentage for operation of the taxpayer's machinery and equipment. We then allocated the cost of the primary electrical distribution system between the two uses, and allowed investment tax credit for the percentage determined to be allocable to the operation of machinery. In respondent's view, no part of the primary electrical distribution system in issue is eligible for investment tax credit.

Respondent argues that the electrical distribution system in the instant case was designed to meet the electrical requirements of the cafeteria as a whole rather than just the kitchen requirements and the location and routing of the electrical components were planned to meet electrical power requirements petitioners might have from any source. The components of the electrical distribution system, in respondent's view, were installed to be permanent and removal would render the cafeteria building useless. Respondent points out that the reasonable adaptability of the electrical distribution system with minimal effort to accommodate another cafeteria, a restaurant or a retail sales establishment such as a furniture store, indicates that the system relates to the overall operation or maintenance of the building rather than relating to the function of specific pieces of kitchen machinery or

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equipment. Respondent recognizes that his argument is contrary to our holding in Scott Paper Co., supra. Following our holding in Scott Paper Co. v. Commissioner, 74 T.C. 137, 184 (1980), we focus on the ultimate use of the electrical power in petitioners' cafeterias in order to determine whether the electrical distribution system constitutes a structural component. An allocation should then be made based on the qualifying and nonqualifying uses of the power.

In Scott Paper Co. v. Commissioner, supra, we addressed whether the primary electric improvements to the taxpayer's pulp and paper-making plant qualified as section 38 property. Rejecting the government's argument that the entire primary electric should be viewed as a structural component of the facility as a whole, we stated that "[t]he primary electric possesses dual characteristics. It is a system that distributes electrical power to various parts of the facility, and yet, each component of the primary electric is individually responsible for the distribution of electrical power to the specific circuitry which is down the line from that component." 74 T.C. at 174. After noting that the taxpayer's business operations could not operate without the primary electric, we allocated between the structural and process functions served by the electrical components as follows:

> it is appropriate to break down the electrical load carried by the primary electric in the same way as that of the secondary electric--by

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the amount of load caused by each category of consumptive device, i.e., lighting, ventilation, air-conditioning, process machinery, etc. Thus, it is appropriate to allow an investment credit for the primary electric improvements in a manner similar to that used by respondent with respect to the secondary electric improvements, i.e., by reference to circuit diagrams and electrical loads. To the extent that the primary electric carried electrical loads to be used for pulp and paper production processes or other such qualifying uses, the investment credit will be allowed for the primary electric improvements.

To the extent that the primary electric improvements relate to the overall operation [or] maintenance of buildings, they are structural components of such buildings, and they do not qualify as tangible personal property. [Scott Paper Co., supra at 185-186.]

From the above it is clear that in Scott Paper Co. we allocated between the amount of the primary electric allocable to machinery and to building operations on the basis of the load carried to each. The parties have stipulated the load with respect to machinery and with respect to the building in each cafeteria by stipulating the kilovolt-amperes applicable to each. We have set forth these stipulated figures in our findings. Since we have held the kitchen air makeup unit to be section 38 property, the stipulated figures including this unit are the appropriate figures to be applied to the cost of the various primary electric systems. In our view this method of allocation directly follows that held to be proper in the Scott Paper Co. case.

Decision will be entered under Rule 155.

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74-B JU 11.7/2:1986-130

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T. C. Memo. 1986-130

UNITED STATES TAX COURT

RICHARD D. CHILES, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

RICHARD D. CHILES and PATRICIA A. CHILES, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 15435-81,
15436-81.

Filed April 1, 1986.

Richard D. Chiles and Patricia A. Chiles, pro se.

Frank Simmons and Robert W. West, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

SCOTT, Judge:* Respondent determined deficiencies in petitioners' income taxes and additions to tax for fraud under section 6653(b)[1] for the years and in the amounts as follows:

Petitioners	Year	Deficiencies in Income Tax	Additions to Tax, I.R.C. 1954 Sec. 6653(b)
Richard D. Chiles	1975	$ 7,314.96	$3,657.48
Richard D. and Patricia A. Chiles	1976	2,073.82	1,036.91
	1977	14,332.63	7,166.32
	1978	19,609.22	9,804.61
	1979	8,579.01	4,289.51

These cases were consolidated for trial, briefing and opinion. The issues for decision are:

(1) Whether petitioner-husband had unreported income for 1975 in the amount of $26,448.04, as determined through use of the bank deposits method.

(2) Whether petitioners had unreported income for 1976, 1977, 1978 and 1979 in the respective amounts of $25,737.38, $45,343.66, $45,586.18 and $23,771.33, as determined through use of the bank deposits method.

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* By Order of the Chief Judge, this case was reassigned from Special Trial Judge Randolph F. Caldwell to Judge Irene F. Scott.

1 Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect during the years here in issue.

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(3) Whether petitioners are entitled to a bad debt deduction for 1977 under section 166.

(4) Whether any part of any deficiency for each of the years 1975 through 1979 is due to fraud, so as to render petitioners liable for additions to tax under section 6653(b).

(5) In the alternative, in the event that fraud is not established:

(a) Whether petitioner-husband's failure to file a return for 1975 was due to reasonable cause and not due to willful neglect;

(b) whether any part of any deficiency for each of the years 1975 through 1979 is due to negligence or intentional disregard of rules or regulations.

(6) Whether assessment of any deficiency or addition to tax for 1976 is barred by the statute of limitations in section 6501(a).

Respondent conceded on brief that certain property sold by petitioners during 1978 was their principal residence and that the gain on the sale was properly deferred pursuant to section 1034. This concession will be reflected in the computation under Rule 155.

FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly.

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Petitioners, husband and wife, who were residents of Ocean Springs, Mississippi, at the time of the filing of their petition in docket No. 15436-81, filed joint Federal income tax returns for the calendar years 1976, 1977, 1978 and 1979. Richard D. Chiles (petitioner) did not file a Federal income tax return for 1975. He resided in Ocean Springs, Mississippi, at the time of the filing of his petition in docket No. 15435-81.

Prior to 1972, petitioners lived in the area of Grand Rapids, Michigan, with their four children, Mrs. Chiles' mother, and Mrs. Chiles' half-sister. Petitioner followed the trade of an experienced welder and sheetmetal mechanic. Mrs. Chiles worked in automobile factories for approximately 7 years prior to 1972.

In 1972, petitioners decided to move with their family to Walsenburg, Colorado, where petitioner (who held a commercial pilot's license) was to be employed as manager of the local airport at a salary of about $225 per month. He was also furnished a house in which to live.

The family remained in Walsenburg until early 1976, when they moved to Ocean Springs, Mississippi. Petitioner began the operation as a sole proprietor of a skating rink in Biloxi, Mississippi, under the name of Skateland, and a checking account for this business was opened in the Gulf National Bank on February 3, 1976.

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Later in 1976, petitioner began the operation of a second proprietorship, a used car business under the name D&D Motor Sales, in Biloxi. A checking account for this business was opened in the Gulf National Bank on November 4, 1976. There were 11 deposits totaling over $17,000 in that account for the 2-month period of November and December 1976; 84 checks totaling $16,206 were written on the account in the 2-month period. Petitioners' joint return for 1976 did not contain a Schedule C for D & D Motor Sales or in any other way reflect the operations of that business.

Petitioner continued to operate the two proprietorships until some time in June or July 1977, at which time the family moved to Riverton, Wyoming. Petitioners purchased approximately 48 acres of land in or near Riverton on which they placed a double-sized trailer which the family used as their home until April or May 1978, at which time the family moved back to Ocean Springs, Mississippi.

Prior to the move back to Mississippi, petitioners subdivided the 48-acre tract into 3 parcels which they sold in 1978. Petitioners realized a gain of $14,594 on the sale of the parcel containing the trailer. Their investment in a new residence in Mississippi was $1,388 less than the selling price of the parcel containing the trailer. They reported the $1,388 as a short-term capital gain and elected to postpone recognition of the remainder of the gain ($13,206) pursuant to section 1034. In the notice of deficiency,

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respondent disallowed the postponement of the gain and increased petitioners' income for 1978 by that amount. As stated above, respondent on brief has now conceded this adjustment.

Upon the family's return to Ocean Springs, they purchased a house at One Davis Bayou as their new residence. Petitioner was compelled to repossess the residence which he had sold prior to moving to Wyoming, and he converted that property to a duplex held for rental.

During the taxable years here in issue petitioner owned at various times 9 airplanes, 6 of which he sold during these years. One of such sales that occurred in 1978 was of a Mooney airplane for which petitioner was paid $22,500. Neither that sale nor the sales of the other 5 airplanes was reported on petitioners' tax returns.

On December 13, 1977, while petitioner was living in Wyoming, he received a check for $800 drawn payable to the order of "Dicks Welding Service." The check bore the notation that it was for "Steel Work." The check was endorsed by Mrs. Chiles and was deposited in petitioners' account at the Riverton State Bank. That transaction is not reported on the return for 1977.

Upon audit of petitioner's tax liability for 1975 and petitioners' joint returns for each of the years 1976 through 1979, respondent's agents found that petitioner had had dealings in airplanes, boats and guns during the period 1975

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through 1979 which were not reflected on the returns and with respect to which petitioners refused to furnish any records. Respondent used the bank deposits method of determining petitioners' income for the years here involved.

After adjustments for returned items, transfers of funds, loans and other nontaxable income deposits, the net amounts of deposits in bank accounts maintained by petitioner-husband during the taxable year 1975 were as follows:

Bank	Account Number	Net Deposits
Minnequa Bank of Pueblo	031-231-8	$ 1,991.87
St. Mary's Credit Union	3533	5,827.84
Otero Savings and Loan	0500371	17,528.33
Minnequa Bank	0399566	1,100.00
Total		$26,448.04

With the exceptions noted hereafter, after adjustments for returned items, transfers of funds, loans and other nontaxable income deposits, the net amounts of deposits in bank accounts maintained by petitioners during the taxable years 1976 through 1979 are as follows:

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Bank	Account Number	12-31-76	12-31-77	12-31-78	12-31-79
1st National Bank of Jackson County	1787942	$ 5,773.65	$13,433.36	$ -0-	$ -0-
Minnequa Bank of Pueblo	0312318	2,616.36	-0-	-0-	-0-
Gulf National Bank - "Skateland"	1009443	13,811.00	6,585.09	-0-	-0-
Gulf National Bank	1800275-0	2,488.75	-0-	-0-	-0-
Gulf National Bank - "D & D Auto"	1011839	15,532.69	26,439.72	-0-	-0-
Otero Saving and Loan	0500371	45.93	-0-	-0-	-0-
Riverton State Bank	300847	-0-	1,233.80	15,510.00	-0-
1st National Bank of Riverton	0018176	-0-	28,587.88	-0-	-0-
1st Mississippi National Bank	4055661	-0-	-0-	32,580.96	36,505.02
Riverton State Bank	805781	-0-	-0-	46.81	5,099.42
Total Net Deposits		$40,268.38	$76,279.85	$48,137.77	$41,604.44

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A deposit of $46.81 in the Riverton State Bank which is included in the above schedule in 1978 should have been shown as a 1977 deposit, and a deposit of $5,022.42 included in 1979 should have been shown as a 1978 deposit.[2]

During 1975, petitioner did not receive any gifts. During 1975, petitioner did not receive any inheritances, legacies or devises. During 1975, petitioner did not receive any nontaxable or excludable income, receipts, cash or other assets. During 1975, petitioner had no allowable business expenses or excess itemized deductions.

During the taxable years 1976 through 1979, petitioners did not receive any gifts. During the taxable years 1976 through 1979, petitioners did not receive any inheritances, legacies or devices.

On their Federal income tax return for the taxable years 1976, 1977, 1978 and 1979, petitioners reported taxable income of $5,608, $1,743, $5,768.02 and $7,443.07, respectively.

On the Schedule C for D & D Motor Sales attached to their 1977 return, petitioners claimed a deduction on line 17 (Bad debts arising from sales or services) of $3,500, which they described as being for "2 cars stolen." Respondent disallowed the deduction with the following explanation:

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2 Respondent filed a motion for leave to amend his answer to conform the pleadings to the proof and the Court granted this motion.

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The bad debt deduction shown on your return as the cost of two stolen autos is not allowable under Section 166 of the Internal Revenue Code because the cost of the stolen autos has been deducted through cost of goods sold. Accordingly, your taxable income for 1977 is increased by $3,500.00.

During the course of the examination by a special agent of respondent, petitioner revealed only two of the bank accounts he maintained and stated that his only sources of income were the skating rink, the used car lot, and the proceeds of the land sales in Wyoming. Petitioners demanded the return of some of their records which had initially been furnished the special agent before the special agent had the opportunity to examine them. They refused the agent's request for records relating to sales of airplanes, boats and guns, stating to the agent that those were personal items and none of the Internal Revenue Service's business.

OPINION

The first issue is whether petitioner (for 1975) and petitioners (for 1976 through 1979) had unreported income as determined by respondent.

Respondent computed petitioner's income for 1975 and petitioners' income for each of the years 1976 through 1979 by the bank deposits method. In Harper v. Commissioner, 54 T.C. 1121, 1129 (1970), we stated:

Where a taxpayer has made numerous deposits in bank accounts, the sources or nature of which are not accounted for or recorded in books and records maintained by him, determinations made by the Commissioner of income subject to tax on the basis of such deposits have been approved in many instances; and it has been repeatedly held that a presumption of correctness attaches to such determinations and that the

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taxpayer has the burden of overcoming such presumption. [Citations omitted.] Use of the bank-deposits method is proper even when the taxpayer keeps books and records which support his return as filed. Campbell v. Guetersloh, 287 F.2d 878 (C.A. 5, 1961). Respondent is not bound to accept a taxpayer's return or his books at face value. Holland v. United States, 348 U.S. 121 (1954). * * *

In this case petitioners did not furnish respondent with sufficient records to compute their income for the years in issue and specifically refused to furnish any records relating to petitioner's dealings in airplanes, boats and guns. Based on this record, we conclude that respondent quite properly used the bank deposits method of determining petitioners' income for each of the years in issue.

Though not conclusive, bank deposits are prima facie evidence of income. Estate of Mason v. Commissioner, 64 T.C. 651, 656 (1975), affd. 566 F.2d 2 (6th Cir. 1977). In the instant case, the parties have stipulated the net deposits, i.e., the deposits after adjustments for returned items, transfers of funds and other nontaxable income. They have also stipulated (or petitioners have admitted) that they received no gifts, inheritances, legacies, devises, or "any nontaxable or excludable income, receipts, cash or other assets." Such broad and seemingly all-inclusive stipulations would appear to negate any eliminations from the stipulated net deposits.

Nevertheless, petitioners contend that they brought a substantial amount of cash into the taxable years which

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accounts, in some undetermined amount, for some of the deposits. They claim that this cash was composed of an accumulation of savings for years prior to 1972 when they moved to Colorado and of the proceeds of the sale of their residence in Michigan prior to that move. Petitioners also claim that they received insurance proceeds of several thousand dollars in respect of theft and casualty losses and tenant-inflicted damage to their rental property.

While it is not unreasonable that petitioners had some proceeds from the sale of the Michigan residence, and perhaps some savings when they moved to Colorado, there is no satisfactory proof of the amount they had or that it was deposited and redeposited in bank accounts at any time, and certainly not deposited during the years here in issue. The record is not clear as to the years petitioners claim to have received the insurance proceeds. If any accumulated cash funds or insurance proceeds were deposited, the record does not show into which bank accounts the deposits were made or the years in which the deposits were made. The stipulation of the net deposits after all proper adjustments for the years here in issue is contrary to a claim that any such funds were deposited during these years.

On the basis of this record, we hold that petitioners have failed to carry their burden of showing error in respondent's determination of unreported income, and his determination, as modified by the shifting of the years of

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the deposits in the Riverton State Bank from 1978 and 1979 to 1977 and 1978 (as set out in the Findings of Fact), is approved.

The next issue is whether petitioners are entitled to a deduction in 1977 for two automobiles stolen from their used car lot. Petitioners presented no evidence on this issue at trial, and we take it they have abandoned the issue. In any event, we conclude that respondent's disallowance was correct. The cost of the automobiles purchased by petitioners was included in the cost of goods sold; therefore, to allow a deduction for theft of automobiles would amount to a double deduction for the same item.[3]

The next issue is whether petitioners are liable for additions to tax for fraud. Section 6653(b) provides for an addition to tax if any part of an underpayment (deficiency) is due to fraud. Fraud is not imputed or presumed. The burden is upon respondent to prove fraud by clear and convincing evidence. Section 7454(a); Rule 142(b), Tax Court Rules of Practice and Procedure.

Petitioner filed no return for the year 1975. We have held that he had unreported income of $26,448.04 for that year based on his failure to show error in respondent's computation as set forth in the notice of deficiency. The

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3 Clifton v. Commissioner, T.C. Memo. 1985-395.

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differences in petitioners' income as determined by the bank deposits method and their reported income for each of the years 1976 through 1979 were $25,737.38, $45,343.66, $45,586.18 and $23,771.33, respectively. Again, based to an appreciable extent on petitioners' failure to show error in respondent's computation, we have held that petitioners have underreported their income in these amounts.

However, to show fraud respondent must establish that there is in fact unreported income and that the taxpayer failed to report such income with the intent to evade tax. Respondent cannot rely on petitioners' failure of proof to show unreported income for the purpose of establishing fraud. Based on this record, we conclude that respondent has in fact shown unreported income in each year here in issue. The record shows that petitioner was supporting six to seven people during the years 1972 through 1974 on a salary of about $225 a month. Petitioner also testified that he bought an airplane for $11,500 during these years. The record shows petitioners took trips during these years, at least one of the trips being to Mexico. Even if petitioners did have some funds from savings and the sale of a house in Michigan in 1972, respondent has shown facts to clearly establish that they could not have had a sufficient amount remaining in 1975 or any subsequent year to account for the net bank deposits in excess of reported income. The cash petitioners had in 1972 when they moved to Colorado was

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variously estimated from $15,000 to $30,000. In addition to supporting his family, petitioner testified that he was a gun collector and a pilot. He stated that all during this period of time he had one or more airplanes. On this record, we conclude that respondent has shown a substantial understatement of income in each of the years here in issue. In Stone v. Commissioner, 56 T.C. 213, 224 (1971), we stated:

> The mere existence of the deficiencies in tax liability does not show fraud. * * * However, exceedingly large discrepancies between the [taxpayer's] actual net income and the net income reported on the tax returns do constitute evidence supporting fraud, when such discrepancies are unexplained. [Citations omitted.] * * *

Petitioner's failure to disclose all of petitioners' bank accounts to respondent's agent is evidence of fraud. Stone v. Commissioner, supra at 224. Furthermore, petitioners' demand for the return of a portion of the records they initially produced for respondent's agents and their refusal to furnish any records of dealings in airplanes, boats and guns indicate to us that petitioners were concealing evidence of income which they had not reported, certainly a badge of fraud.

In addition, there are three specific omissions of income that deserve comment. The first is a total omission from petitioners' 1976 return of any reference to D & D Motor Sales. Petitioner was operating that business in November and December 1976 and bank records for that

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business show deposits totaling more than $17,000 and checks drawn against the amount of $16,206. The $17,000 was composed of 11 separate deposits.

The second item concerns a check in the amount of $800 issued on December 13, 1977, by one Spencer Byington of Riverton, Wyoming, for "Steel Work." That check was drawn payable to "Dicks Welding Service" and was endorsed in Mrs. Chiles' handwriting and deposited in petitioners' account at the Riverton State Bank. Mindful that petitioner was an experienced welder and sheetmetal mechanic by trade, and that the return for 1977 shows no source of income to petitioners while they were in Wyoming, we conclude that petitioners were not truthful in their denial of any such business endeavor as "Dicks Welding Service."

The third item of specific omission concerns the sale by petitioner of a Mooney airplane in 1978 for $22,500. Petitioner testified that some years prior he had been given a Piper Apache by a friend which he traded for the Mooney that he sold for $22,500. Petitioner stated that the Apache was an old plane in bad condition when it was given to him and that he fixed it up before he traded it for the Mooney. Petitioner testified that he would buy old airplanes and fix them up and then sell them.

Petitioner's claim is that since in his view airplanes, guns and boats were a hobby with him and not a business, anything he made on the sale of these items was

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not income. He said these items were a hobby and sometimes he made money on a sale and sometimes he did not. Clearly any gain petitioner made on the sale of airplanes, guns and boats should have been reported as income. However, in determining whether the omission of the income he made on the sales of these items was fraudulent with intent to evade tax, the question is whether from the record as a whole we find the evidence to be clear and convincing that he did knowingly fail to report this income. On the basis of this record, we conclude that petitioner did knowingly fail to report all his income.

Petitioner testified that he or his wife revealed to the persons who prepared their returns for the years 1976 through 1979 all of the income which petitioners had. Yet, as the foregoing three specific omissions point up, petitioners had not done so. If in fact petitioners had been attempting to properly report their income, they would have disclosed these sources of income to the tax return preparer and inquired whether they were taxable. In our view, the failure to do so is another effort to conceal income and indicates a fraudulent intent to evade the payment of tax.

Finally, petitioner's failure to file any return at all for 1975, when he had over $26,000 of income, is an indication of fraud.

Considering the record as a whole, we are persuaded that respondent has proved by clear and convincing evidence that a part of the deficiency for each of the taxable years was due to fraud. His imposition of the addition to tax for fraud for all years is, accordingly, sustained.

Fraud having been established, it is unnecessary to consider the issues pleaded in the alternative by respondent.

The last issue is whether the 3-year statute of limitations in section 6501(a) bars the assessment of the deficiency and addition to tax for 1976. The return for that year was filed on or about April 15, 1977, and the notice of deficiency in docket No. 17435-81 was issued on April 3, 1981. Section 6501(a) provides as the general rule that assessment must be made within 3 years after a return has been filed. However, section 6501(c)(1) provides that in the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed at any time. For the same reasons stated in our holding that a part of the deficiency for 1976 was due to fraud, we here find and hold that petitioners' return for that year was false or fraudulent with the intent to evade tax. Therefore, the 3-year statute of limitations is not a bar to assessment of the deficiency and addition to tax for that year.

Decisions will be entered under Rule 155.

742-B JV11.7/2:1986-131

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ORIGINAL

T. C. Memo. 1986-131

UNITED STATES TAX COURT

JAMES A. CHUNG and CAROLE CHUNG, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

NELLO TIBERIO and MARILYN TIBERIO, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 19934-83, 21451-83. Filed April 1, 1986.

Michael J. Christianson, for the petitioners.

Michael K. Phalin, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

COHEN, Judge: Respondent determined deficiencies in 1978 Federal income tax of petitioners James A. Chung and Carole Chung and petitioners Nello Tiberio and Marilyn Tiberio equal to $27,615 and $34,954, respectively. The issues for decision are (1) whether petitioners may deduct under section 174[1] a portion of certain research and experimental expenditures allegedly incurred by a certain limited partnership, and (2) whether petitioners are liable for additional interest, under section 6621(d), on substantial underpayments attributable to tax motivated transactions.

FINDINGS OF FACT

Petitioners James A. and Carole Chung resided in La Mirada, California, at the time they filed their petition herein. They filed a joint Federal income tax return for 1978 with the Internal Revenue Service Center in Fresno, California.

Petitioners Nello and Marilyn Tiberio resided in Marina del Rey, California, at the time they filed their petition herein. They filed a joint Federal income tax return for 1978 with the Internal Revenue Service Center in Fresno, California.

The deductions in issue are the respective distributive shares of petitioners James A. Chung (Chung) and Nello Tiberio (Tiberio) in a partnership loss reported by Scientific

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[1] Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954, as amended an in effect during the year in issue.

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Instruments Research Institute (SIRI). SIRI was a California limited partnership of which Robert R. Young (Young) was a general partner and Chung and Tiberio were limited partners.[2]

Young possessed both education and experience as an engineer. In or about 1972, Young and 13 other individuals formed Anatronics Corporation (Anatronics) to develop Young's concept for a programmable discrete analyzer system (PDA), on which Young had already begun work at home in his garage. The PDA was an advanced computer-controlled clinical chemistry analyzer for use both in special esoteric chemistry procedures and in routine chemistry tests performed by hospital and independent clinical laboratories. Blood analysis would be a primary application of the PDA. An integral component of the PDA was the spectrophotometer, which uses light to detect and identify various chemical substances. Between 1971 and 1975, Young obtained various patents on the design and components of the PDA. Such patents listed Anatronics as assignee.

Obtaining sufficient funding was a constant concern for Young throughout this period. He and the 13 other founders made capital contributions to Anatronics totaling $175,000 from 1972 through 1975. Anatronics Limited Partnership, of which Young and Anatronics were general partners, was formed in March 1973 as a vehicle to raise additional capital for Anatronics without reducing Young's ownership interest in the corporation. Through

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[2] Tiberio owned his partnership interest in SIRI through a general partnership with another individual.

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1976 the partners contributed a total of $709,000 to the capital of Anatronics Limited Partnership. In 1977 and 1978, Young and other shareholders of Anatronics contributed an additional $558,000 to the corporation through the purchase of additional shares and the exercise of stock options.

Anatronics completed its first prototype of the PDA in 1974, which received considerable interest in the industry. In 1976 Anatronics obtained approval from the Food and Drug Administration to market the PDA. As of July 31, 1978, Anatronics was engaged in the fabrication and final assembly of its first four PDAs, one of which was to be delivered to St. Mary Medical Center in Long Beach, California (St. Mary's), for clinical testing. Anatronics planned to start full production of the PDA during the third quarter of 1978 and to ship one unit per month from October 1978 through July 31, 1979, which Anatronics estimated would produce sales and earnings of $1.8 million and $64,000, respectively. As of July 31, 1978, Anatronics anticipated shipping 36, 76, and 144 PDAs in its fiscal years ending July 31, 1980, July 31, 1981, and July 31, 1982, respectively. Anatronics projected sales and earnings for the 1982 fiscal year of $30.6 million and $5.1 million, respectively.

Despite its past progress and favorable forecasts, Anatronics experienced considerable financial difficulty after July 31, 1978. On or about that date Anatronics unsuccessfully attempted to establish an $8 million line of credit to finance the production of 14 PDAs, the expansion of its office and

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manufacturing facilities, the implementation of its marketing program, and an increase in working capital. Unable to attract new capital, Anatronics was barely able to satisfy its overhead expenses during July 31, 1978, through December 23, 1978, even though it was operating with minimal employees. By the latter date the project had exhausted Young's personal net worth, and Anatronics needed additional money to complete development and testing of the PDA.

In late 1977 or early 1978, Young attended a financing seminar presented by Paul Harris (Harris), a resident of Georgetown, Grand Cayman, British West Indies. Young remained in contact with Harris after the seminar and indicated to Harris that Anatronics needed additional financing. Harris suggested that Young create a partnership and suggested certain aspects of its structure.

SIRI was formed on December 23, 1978, and its general partners were Young and Gene Koon, an attorney. Chung and Tiberio each owned (indirectly, with respect to Tiberio) one-half of a limited partnership unit which constituted a one-sixth limited partnership interest. The partnership agreement of SIRI described its business and purpose as follows:

> The primary business and purpose of this partnership is research and development for the design and manufacture of biomedical electronic equipment.
>
> The Partnership will enter into research and development contracts up to the limits of funding obligations herein. The initial contract will be for the research, design, and development and clinical trial of computer-controlled biochemical analyzers.

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> Any and all patents issued as a result of the contracted research and development will be the sole property of the Partnership.

The general partners were not required to contribute assets to SIRI but received their interest in the partnership "by virtue of their efforts and their endeavors in the researching of the market for and the planning and development of organization and promotional activities for biomedical electronic equipment." The partnership agreement provided that the limited partners would contribute $136,000 for each limited partnership unit. Like the other limited partners of SIRI, Chung and Tiberio contributed in cash only one-fourth of the amount provided in the partnership agreement and signed a promissory note in favor of SIRI for the balance.

On December 25, 1978, Young traveled to Georgetown to meet with Harris. Several other partners of SIRI followed during the next few days.

On December 29, 1978, Young and Harris executed an "Option Agreement" on behalf of the limited partners of SIRI and AFA International (AFA), a Grand Cayman corporation, respectively. The Option Agreement provided that each of the limited partners granted AFA the right to purchase his income distributions from SIRI. The option extended for 10 years and was exercisable by AFA beginning 1 year and 1 day after the date of the agreement. AFA agreed to pay each limited partner an "option premium" equal

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to the amount of the note that he executed in favor of SIRI and to pay an identical sum upon exercise of the option.

That same day SIRI and International Scientific Research Foundation (ISRF), a corporation with principal offices in Georgetown, entered into a "Research and Development Contract." Under such contract SIRI agreed to pay ISRF $2,040,000, through mutually agreeable progress payments, in exchange for ISRF's performing the following functions:

1. Design, construct, document and test a Spectrophotometer designed for use as a component part of biomedical electronic testing equipment, in accordance with a "statement of work" (Attachment Number 1) which is attached hereto and incorporated herein by this reference.

2. Conduct a complete market research study analysis, for the component as it relates to sales and marketing of the component in the International original equipment manufacturing market place, also described in the aforementioned statement of work.

3. Provide periodic reports of progress of the research and development on not less than a quarterly basis as required by the statement of work, to the general partners of SIRI-I Spectrophotometer Project.

4. Provide plans, specifications designs, market studies, and all product documentation to the general partners of SIRI-I, Spectrophotometer Project as available and upon demand.

5. Provide one (1) prototype model of the subject component as suitable for installation in biomedical electronic testing equipment as provided in the statement of work, supervise the installation thereof and supervise the completion of acceptance tests and acceptances defined by the statement of work.

(a) Upon completion of acceptance tests and acceptance, the prototype model is to be rendered inoperative and returned to SIRI-I, Spectrophotometer Project for sale as scrap.

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6. Design document and implement computer software and firmware required for successful operation of the component in accordance with the statement of work.

7. Engage the services of an attorney, admitted to practice patent law, to complete patent search, applications for patents, and issuance of final patents on the subject component.

Young signed the Research and Development Contract on behalf of SIRI, and Harris executed it on behalf of ISRF.

The "Statement of Work" referenced in and attached to the Research and Development Contract defined the objective of the project as follows:

OBJECTIVE: The objective of the work scope is to design, develop, fabricate, test and evaluate a spectrophotometric device suitable for use in a clinical environment as a self contained microprocessor controlled unit or as a component of a larger unit in accordance with the Functional Unit description herein.

The Statement of Work contained detailed technical specifications for the design, characteristics, and function of the spectrophotometer that was the subject of the Research and Development Contract.

Also on December 29, 1978, ISRF and Anatronics entered into a "Research and Development Subcontract." Under this contract ISRF agreed to pay Anatronics $1,435,000, through mutually agreeable progress payments, in exchange for Anatronics' performing the following functions:

1. Construct one (1) prototype model of a spectrophotometer in accordance with plans and specifications provided by ISRF and in accordance with

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the master statement of work provided by Scientific Instruments Research Institute, Phase I, Spectrophotometer Project.

2. Provide ISRF with manufacturing documentation of all construction completed hereunder.

3. Under the supervision of ISRF, conduct acceptance tests as defined by the statement of work.

4. Provide consulting services to ISRF relative to the design and implementation of software and firmware as required by ISRF.

The "Statement of Work" attached to the Research and Development Subcontract was identical to that attached to the Research and Development Contract between SIRI and ISRF. Young and Harris signed the Research and Development Subcontract on behalf of Anatronics and ISRF, respectively.

Contemporaneously with the execution of the contracts, the various parties transferred cash through their respective bank accounts with the Grand Cayman branch of Barclay's Bank International. AFA transferred the option premiums to the limited partners of SIRI. The limited partners then transferred these funds to SIRI, and Harris wrote "Paid in Full" across each note payable to SIRI given by the limited partners. SIRI transferred $406,000 (which equaled the aggregate initial cash investments of the limited partners plus the aggregate transfers applied to satisfy the notes less $2,000) to ISRF.

Young did not meet anyone purportedly on the staff of ISRF before consummating the above transactions.

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In January 1979, Anatronics received $90,000 from ISRF. On March 23, 1979, Young sent a newsletter to the shareholders of Anatronics, in which he stated:

> In my letter of March 27, 1978, I told you about initiating an audit to determine our status in response to demands for equity participation by several employees. In a nutshell, the audit was negative and the employees departed. I then launched an all-out effort to overcome our technical shortcomings. In spite of having had severe damage to the System in mid-August, we have done it! Our Spectrophotometer is six times better than the best our competition offers. Our device which dispenses patient samples is approximately four times better than competitive dispensers. Our units which dispense reagents are an order of magnitude better than competition. Our detection cells are producing results about five times better than competition. Most important, we will send System Number 1 to St. Mary's for the start of Clinical Trials on or before April 16, 1979.
>
> Obviously, to do what we have done takes money. During 1978, we received $306,610 and paid out $312,960. The breakdown of receipts and disbursements is attached. While these numbers are not a formal financial statement, they do portray a representative picture of what was required to sustain our efforts during the year.
>
> In December, 1978, Mr. Gene Koon and I formed a new limited partnership called Scientific Instruments Research Institute (SIRI). The purpose of this limited partnership is to fund companies engaged in high technology research and development in exchange for rights to long-term earnings. The limited partner puts at risk his initial investment plus the proceeds from the sale of an option on the right to purchase his future rights. In effect this 4 to 1 tax shelter moves current taxable income from ordinary tax rates to long-term capital gains rates and then provides for a future income stream. If a 4 to 1 tax shelter is attractive to you, please call me to arrange a complete presentation of the opportunity.
>
> In the course of developing the PDA System, we have experienced difficulties which we never expected; but we have overcome them. Even though we are behind our expected schedule, we are still years ahead of

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> competition. We are rapidly approaching the beginning of Clinical Trials and their successful completion means success for Anatronics. We have only ourselves to rely upon, and if we falter now, we will be denied the success we all deserve. If you can participate financially, I encourage you to do so.

In April 1979, Anatronics delivered the PDA to St. Mary's for clinical trials. St. Mary's intended to purchase the PDA if testing was successful. Anatronics conducted the trials at St. Mary's for approximately 8 months. During that period an employee or consultant with Anatronics stayed from 9:00 or 10:00 a.m. until late into the night each day (including weekends) at St. Mary's. Young himself was present at St. Mary's during most of this time. Because various technical problems prevented the PDA from performing satisfactorily during the trial period at St. Mary's, Anatronics transferred the unit to its plant for further development.

From the first calendar quarter of 1979 through the first quarter of 1980, ISRF sent quarterly status reports to SIRI as required in the Research and Development Contract. All but the first of these reports indicated that the reports were "based solely on reports from our sub-contractors." ISRF performed no substantial work under the Research and Development Contract.

On its U.S. corporation income tax returns for each of the fiscal years ending July 31, 1978, through July 31, 1981, Anatronics reported taxable losses ranging from $587,937 to $1,130,271.

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On its U.S. partnership return of income for 1978, SIRI reported a deduction for "research and development costs" of $408,000, $406,000 of which consisted of the December 29, 1978 payment to ISRF under the Research and Development Contract. Chung and Tiberio reported their distributive share (indirect, in the case of Tiberio) of such loss in their respective Federal income tax returns for 1978.

Respondent denied petitioners' respective deductions for such losses in full. In his amended answer respondent alleged that the increased interest rate provided in section 6621(d) was applicable.

OPINION

The primary issue before us is whether SIRI's payment of $406,000 to ISRF under the Research and Development Contract constituted a deductible research and experimental expenditure under section 174(a).[3] Respondent argues, among other things, that petitioners have not proven that any amount was spent for research and development or that petitioners had the necessary basis in their partnership interests to deduct the partnership

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3 Section 174(a)(1) provides:

> (a) Treatment as Expenses.--
>
> (1) In general.--A taxpayer may treat research or experimental expenditures which are paid or incurred by him during the taxable year in connection with his trade or business as expenses which are not chargeable to capital account. The expenditures so treated shall be allowed as a deduction.

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losses. Petitioners contend that respondent is merely suspicious because the investors went to the Caymen Islands.

Except as to new matters not raised in the statutory notice of deficiency, respondent's determination is presumed correct, and the taxpayer bears the burden of proving otherwise. Welch v. Helvering, 290 U.S. 111 (1933); Rockwell v. Commissioner, 512 F.2d 882 (9th Cir. 1975), affg. a Memorandum Opinion of this Court; Rule 142(a), Tax Court Rules of Practice and Procedure. Based upon the entire record, we conclude that petitioners have failed to satisfy their burden of proving that SIRI paid or incurred any deductible research and experimental expenditures in 1978.

The crux of petitioners' argument, based upon the testimony of Young at trial, is that SIRI was developing a "second spectrophotometer," different from that used in the PDA, for industrial application. The evidence, however, supports the stronger inference that Young merely used SIRI and the Cayman entities as conduits for additional infusions of capital to be used by Anatronics to develop the PDA.

Young testified that the "second spectrophotometer" might be used in testing milk, petroleum, and other nonmedical fluids. Both the partnership agreement of SIRI and the Research and Development Contract between SIRI and ISRF, however, described the subject of the venture as biomedical electronic equipment. Although Chung and another limited partner of SIRI agreed with Young's testimony, two other limited partners testified that they

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believed SIRI to be involved in the development of a "blood analyzer" or a "machine that was to test blood." The only reasonable inference from Young's description of SIRI in the March 1979 newsletter requesting additional funding for Anatronics' development of the PDA is that SIRI would be used to provide such funding. There is no mention of a new product or venture.

Whereas Anatronics held patents on the PDA, including its component spectrophotometer, there is no evidence that SIRI owned even minimal rights to any spectrophotometer, or that SIRI would ever engage in a trade or business. Cf. Green v. Commissioner, 83 T.C. 667, 686-687 (1984). This void is particularly significant in light of Young's testimony acknowledging that the purported second spectrophotometer was based upon the same concepts as that contained in the PDA.

The various agreements involving SIRI, Anatronics, AFA, and ISRF indicate that the overall arrangement involved nothing more than the circular flow to Anatronics of most of the initial cash contributed by the SIRI limited partners, most of whom were Anatronics investors.[4] Harris represented both AFA and ISRF; the option premium from AFA to each limited partner exactly equaled the amount of the note given by the partner to SIRI; the

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[4] Young testified that Anatronics received $81,000 from ISRF subsequently to the receipt of $90,000 in January 1979. Even if true, and Anatronics' bank statements and deposit slips do evidence unidentified deposits in such amount, this fact does not affect our conclusion as to the arrangement.

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aggregate of all such payments plus the partners' initial cash contributions (less $2,000) was transferred back to ISRF; and both the signing of the various contracts and the associated transfers of cash occurred on the same day. Young admitted that he did not meet the staff of ISRF prior to his engaging ISRF to perform this extremely technical purported development project. Indeed, nothing indicates that Young knew or cared, nor can we determine, whether ISRF even had employees or was simply a shell created by Harris. Young's indifference was quite understandable, however, because ISRF performed no substantial work on the Research and Development Contract.

As of early 1979, Anatronics believed that it was close to completion of the PDA and was operating with a minimal work force. Young spent substantially all of his time testing the PDA at St. Mary's beginning in April 1979. We do not believe that Anatronics possessed the ability or the inclination to embark upon development of a new device for SIRI when Anatronics was on the threshold of what it expected to be a very profitable exploitation of the PDA.[5] Petitioners did not produce any work

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5 A limited partner of SIRI testified that the success of the purported second spectrophotometer would benefit the reputation of Anatronics, and Young testified that cash from sales of the "second" spectrophotometer could be used to fund Anatronics development of the PDA. Young's testimony on this issue was both vague and contradictory:

> Q. You said you had profit in the contract. What contract do you refer to?
>
> A. That was in the ISRF Anatronics contract.

(footnote continued)

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schedules, expenditure records, or any other documentary evidence or other corroboration indicating that Anatronics performed any work on a second spectrophotometer. The quarterly reports sent by ISRF to SIRI are no more than vague recitals, based primarily on summaries prepared by Young. Neither details nor supporting source materials have been provided by Young or by petitioners.

Because petitioners have not persuaded us that SIRI paid or incurred any expenditures for research or experimentation, we hold for respondent on this issue.

(footnote continued from previous page)

Q. You mean Anatronics was to earn a profit performing those services?

A. Anatronics was going to perform services for ISRF under contract, yes, to develop the SIRI spectro.

Q. And you anticipated a profit to Anatronics for performing those services?

A. Yes, we did.

Q. Is this how you intended for SIRI to benefit Anatronics?

A. That way, plus the cash flow that would be developed or generated by the sale of the SIRI spectro.

Q. Except that cash flow belongs to SIRI; is that correct?

A. Certainly the profits did, but the cash flow would go to the manufacturer.

Q. Did you intend for Anatronics to ultimately manufacture the SIRI spectro?

A. That was the intent. It hadn't been fully agreed upon.

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Petitioners have not explained the additional $2,000 loss reported by SIRI except by Young's statement that it was spent for operating expenses. He did not identify such expenses, and there is no evidence that they were indeed deductible items. We hold for respondent with respect to this amount.

Respondent argues that petitioners are subject to the increased interest rate prescribed in section 6621(d), because their investment in SIRI constituted an activity not engaged in for profit. See section 301.6621-2T, Q-4, and A-4, Proced. & Admin. Regs. (Temporary). We deny petitioners' respective deductions for reasons other than lack of profit motive. Section 6621(d) applies only to specifically enumerated tax motivated transactions and is therefore inapplicable. See Law v. Commissioner, 84 T.C. 985, 993 (1985).

Decisions will be entered for the respondent.

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740-B Jul 11,7/2;1986-132

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ORIGINAL

T. C. Memo. 1986-132

UNITED STATES TAX COURT

CHARLES H. MORTON AND CAROL C. MORTON, Petitioners,
v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 10719-85. Filed April 2, 1986.

Held: Husband's contribution to two house funds operated by fire station to which he was attached are not deductible under sec. 162.

Raymond P. Fitzpatrick, Jr., for the petitioners.

Helen C. T. Smith, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

WHITAKER, Judge: Respondent determined a deficiency in the Federal income tax liability of petitioners for the calendar year 1981 in the amount of $880.92. After concession by petitioners, the sole issue for decision is whether petitioners are entitled to a deduction under section 162[1] for their 1981 income tax year in the amount of $381, composed of house dues of $84 and shift dues of $297 paid by Charles H. Morton (Morton) as a member of the Fire and Rescue Service of the City of Birmingham, Alabama. For convenience our Findings of Fact and Opinion are combined.

Some of the facts have been stipulated and they are so found. At the time the petition was filed, petitioners resided in Birmingham, Alabama. During all of the year 1981, and for a number of years prior to that time, Morton had been a member of the Fire and Rescue Service (formerly Fire Department) of the City of Birmingham. During 1981, he was a lieutenant assigned to Station 27 and for that Station he was in charge of the rescue service. Station 27 was composed of two engine companies and one rescue unit, all under the command of a captain. The firemen, as well as members of the rescue unit, worked a 24-hour shift. Morton as the lieutenant in charge of the rescue unit worked one shift every 3 days. During that shift none of the employees, including Morton, was allowed to leave the station except on

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[1] All section references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue.

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official business. Meals had to be eaten on the station premises. The assigned territory of the rescue unit was slightly larger than that of the engine companies, so that the rescue unit and the engine companies did not always respond to the same emergency. Otherwise the rescue unit personnel operated under the same rules, regulations, and controls as the firemen.

As is customary in fire stations generally, Station 27 operated a common mess with two separate funds, a house-dues fund and a shift-dues fund. The house-dues fund was used for the purchase of staple food items and certain nonfood items such as magazines and televisions. All members of the station contributed an equal amount every pay day to this fund which was administered by one of the members of the station designated as the house man. The shift-dues fund was used for the purchase of food for daily consumption. It was administered by a shift man who planned the meals, purchased and cooked the food, using the cooking facilities of the station, and collected the dues from station members. Each member paid shift-dues for each shift worked. In accordance with the practice in effect at Station 27, and apparently throughout the Birmingham Fire and Rescue Service, every station member was expected to contribute to both funds, except that a member with a dietary problem who desired to bring his own food would be excused from contributing to the shift-dues fund.

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Under Section 38 of the Rules and Regulations of the Birmingham Fire and Rescue Service "[t]he Captains shall have the authority to make the necessary house rules to efficiently operate their respective stations." Under this authority the captain of Station 27 established the watches, the daily programs of instruction and work, the meal hours, etc. Participation in the common mess and the contribution to the two funds was important to the morale of every Birmingham fire station. It was and had long been an ingrained custom throughout the Fire and Rescue Service. Participation in the funds was also deemed to be required under the house rules pertaining to Station 27. Captains in the Birmingham Fire and Rescue Service had some minor disciplinary authority for violation of the house rules but the authority to hire and fire members of the Fire and Rescue Service was vested in the Chief of the Department. Any refusal to participate in either fund, except for dietary purposes as permitted, would have resulted in severe peer pressure on the individual and as much pressure from supervisory personnel as could be exerted. Failure to participate in either of the funds without permission from the station captain would have resulted in counseling by the captain. The extent to which a station captain could or would have imposed his limited disciplinary sanctions upon a fireman refusing to contribute to these funds is not clear.

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However no rule, regulation, or ordinance adopted by the City of Birmingham or rule or regulation adopted by the Chief of the Fire and Rescue Service required contribution to these two funds. Participation in the two funds was not, during the year 1981, a condition of employment. It is undisputed that a member of the Fire and Rescue Service would not be fired for refusal to contribute to the two funds. Disciplinary action by the Chief of the Department would not have been imposed and at least theoretically such refusal would not have adversely affected promotion. On the other hand, as a matter of practicality, petitioner had no choice but to participate in the funds.

Petitioners urge us to expand the rule of Sibla v. Commissioner, 611 F.2d 1260 (9th Cir. 1980), affg. 68 T.C. 422 (1977) and Cooper v. Commissioner, 67 T.C. 870 (1977), to include cases such as the instant one where the participation in these funds is mandated by the practicalities of the situation but not required as a condition of employment. We have, however, consistently held in circumstances similar to the case at bar that payments into the common mess constitute a nondeductible personal expenditure under section 262. Duggan v. Commissioner, 77 T.C. 911 (1981); Alvarado v. Commissioner, T.C. Memo. 1985-118, affd. 781 F.2d 901 (5th Cir. 1986). We decline petitioners' invitation to overrule these prior precedents which are indistinguishable from the present case.

Decision will be entered for the respondent.

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T. C. Memo. 1986-133

UNITED STATES TAX COURT

THOMAS V. CASSIDY, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 18125-80. Filed April 3, 1986.

Held, P's motion under Rule 90(c), Tax Court Rules of Practice and Procedure, to enlarge the time in which to answer R's requests for admission and reply to interrogatories and P's alternative motion under Rule 90(e) to withdraw or modify admissions is denied. Held further, R's motion for summary judgment under Rule 121 that the Court determine a deficiency in income tax and additions to tax for fraud under section 6653(b), I.R.C. 1954, is granted.

Thomas V. Cassidy, pro se.

David R. Reid and Jeff P. Ehrlich, for the respondent.

MEMORANDUM OPINION

NIMS, Judge: This case is before the Court on petitioner's motion for extension of time to answer request for admissions and reply to interrogatories pursuant to Rule 90(c),[1] petitioner's alternative motion to withdraw or modify deemed admissions pursuant to Rule 90(e)[2] and respondent's motion for summary judgment under Rule 121. In the deficiency notice dated June 24, 1980, addressed to petitioner, respondent determined the following deficiencies:

Tax Year Ended	Deficiency	Additions to Tax Section 6653(b)
August 31, 1974	$12,865	$11,774
August 31, 1975	22,028	11,014

On September 24, 1980, petitioner, who was then a resident of Illinois, filed a petition in this Court seeking a redetermination of the deficiencies and additions to tax as determined by respondent. Petitioner is an experienced attorney licensed to practice in Illinois.

The issues for decision are whether the 30-day period provided by Rule 90(c) for filing an answer to a request for admission should be enlarged so as to permit petitioner's

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[1] Unless otherwise indicated, all rule references are to the Tax Court Rules of Practice and Procedure. All section references are to the Internal Revenue Code of 1954 in effect for the years in question.

[2] On November 13, 1984, petitioner filed a document entitled Affidavit of Receipt of Requests to Admit and Receipt of Written Interrogatories which this Court has construed to be Petitioner's version of a Rule 90(c) or (e) motion. Accord, Morrison v. Commissioner, 81 T.C. 644 (1983).

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response thereto to be filed; if not, then whether petitioner should be allowed to withdraw or modify the deemed admissions pursuant to Rule 90(e); and whether respondent is entitled to summary judgment.

Resolution of the latter issue is dependent upon the outcome of the first two issues. We will address each issue in order. However, in the interest of clarity it is necessary preliminarily to set forth the prolonged and aggravated history of this case to date.

Background

After the pleadings were closed, the Court set this case for trial on March 22, 1982, at Milwaukee, Wisconsin. The case was set for trial in Milwaukee because Stanley P. Gimbel (Gimbel), petitioner's counsel at that time, maintained his office in that city.

Respondent avers in his motion for summary judgment that "[o]n numerous occasions between December 30, 1980 and February 2, 1982, counsel for respondent attempted to informally consult with then counsel for the petitioner, Stanley P. Gimbel, in order to prepare the above-captioned case for trial. Counsel for petitioner did not provide respondent with answers to any of the questions posed or with any of the documents informally requested by the respondent." In petitioner's untimely reply to respondent's motion for summary judgment, petitioner alleges that Gimbel's failure to cooperate in preparing this case for trial in

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March, 1982, was not of petitioner's own doing, and that he, himself, "repeatedly attempted to reach Gimbel [prior to the trial] but was unsuccessful. Petitioner then phoned the [Court] and discussed the problems he was having with Gimbel and the case with the court and a conflict he professionally had on March 22, 1982."

When this case was called from the calendar for trial in Milwaukee on March 22, 1982, before this Court, Gimbel appeared and represented to the Court that he had written petitioner on December 15, 1981, advising petitioner of his, Gimbel's, desire to withdraw from further representation of petitioner. Gimbel filed with the Court an affidavit to this effect dated March 9, 1982, in connection with his motion to withdraw from further representation of petitioner, which was granted.

The transcript of the hearing before this Court on March 22, 1982, makes it clear that Gimbel disputed the reported representations made by petitioner in the telephone conversation with this Court to the effect that Gimbel was being uncooperative. Respondent's attorney, Joseph R. Peters, also represented to the Court that "I think Mr. Cassidy knew the case was set for trial sometime back, because I kept calling his office to try to speak to him, to see what his plans were and usually when I called, he was out of the office. But I did speak

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to him at least a month ago to ask him what his plans were and at that time, he said he would have to get back and confer with Stan Gimbel."

At the conclusion of the hearing, the Court admonished Gimbel that "I assume you will advise Mr. Cassidy, if you will, please, that the next time he will receive notice of the setting of the trial and that he had better be prepared to go to trial at that time because there will be no additional continuances." Gimbel assured the Court that "I'll personally make sure that he's aware of what was said at Court this morning."

In his motion for summary judgment, respondent further alleges that, by letters dated April 27, 1982, August 19, 1982, October 1, 1982, and April 17, 1984, he informally requested petitioner to answer certain questions and produce certain documents relevant to the issues in dispute. Petitioner did not provide respondent with any of the information requested.

On December 7, 1982, respondent served upon petitioner respondent's request for production of documents, together with respondent's interrogatories to petitioner. Petitioner failed to produce any of the documents requested or provide answers to any of respondent's interrogatories.

On March 8, 1982, respondent served petitioner with a subpoena duces tecum requesting the production of certain documents and testimony. Petitioner did not comply with the subpoena.

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On April 13, 1982, the place of trial was changed to Chicago, Illinois, since Gimbel was no longer in the case and petitioner at that time resided in Springfield, Illinois. On November 14, 1983, the Court sent out a notice of trial on a trial calendar to commence January 30, 1984, in Chicago. On January 3, 1984, there was filed with the Court respondent's notice of a proceeding in bankruptcy involving petitioner, which was followed by a Court order on January 4, 1984, that all proceedings would be automatically stayed.

On March 13, 1984, petitioner received a discharge of debtor order along with an explanatory memorandum from the United States Bankruptcy Court for the Central District of Illinois.[3]

On April 13, 1984, the bankruptcy court judge promulgated an order whereby the automatic stay previously in effect in petitioner's case was lifted "in order to permit the Tax Court proceeding between the parties now pending to proceed forward."

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[3] On November 13, 1984, petitioner filed petitioner's motion to dismiss with prejudice and motion for summary judgment. Petitioner's motion was based on his contention that his tax liability was discharged in bankruptcy. We summarily denied petitioner's motion because petitioner's contention is on its face inconsistent with the explanatory memorandum attached to petitioner's Discharge of Debtor order and the April 13, 1984, order issued by the same bankruptcy judge lifting the automatic stay to permit this case to go forward in the Tax Court. Moreover, the redetermination of an income tax deficiency has "nothing to do with collection of the tax nor any similarity to an action for collection of a debt * * * ." Swanson v. Commissioner, 65 T.C. 1180, 1184 (1976). Accordingly, if there is any question as to the collectability of any income tax deficiencies, which we doubt, that question is beyond the jurisdiction of this Court. Graham v. Commissioner, 75 T.C. 389, 399 (1980).

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On May 16, 1984, this Court entered an order which directed, in part, that the Clerk of the Tax Court calendar this case for trial at the first Chicago, Illinois, trial session during the 1984 fall term. On June 15, 1984, respondent filed with the Court, as required by Rule 90(b), a copy of his first requests for admission, with exhibits attached. On July 18, 1984, the Court issued its notice of trial of this case on a trial calendar commencing October 1, 1984, in Chicago. On August 22, 1984, respondent moved for leave to file respondent's motions to compel responses to respondent's interrogatories to petitioner and to compel the production of documents or to impose sanctions under Rule 104. The motion for leave to file was granted.

On August 22, 1984, respondent also filed a motion for summary judgment based upon petitioner's deemed admissions and a memorandum in support thereof.

On August 31, 1984, respondent's attorney advised the Court by letter that the purpose of the letter "is to inform you that the petitioner has refused to either informally or formally discuss the facts and/or provide the respondent documents in connection with the pending case. Further, petitioner has indicated to Attorney Frank Agostino of this office that he may not appear for the call of the calendar on October 1, 1984. There are pending before the Court motions of the respondent for summary judgment (based upon deemed admissions) and to compel discovery."

Petitioner was copied on the above letter, which was sent to him at P.O. Box 13168, Atlanta, Georgia 30324, his last known address. In response to the letter the Court wrote petitioner, with copy to respondent's attorney, advising petitioner of the receipt of respondent's letter and directing petitioner "immediately to communicate with counsel for the respondent . . . and to cooperate with him to the end that a proper stipulation of facts can be prepared for filing with the Court at 10:00 A.M. on October 1, 1984."

On September 27, 1984 (which was the Thursday before October 1, 1984, the date on which the trial calendar which included this case was scheduled to commence), an entry of appearance was filed by Manning K. Leiter (Leiter) to represent petitioner, and there was also filed by Leiter a motion for a general continuance of the trial. On October 1, 1984, when the case was called from the calendar petitioner's motion for continuance was denied. Also on October 1, 1984, respondent filed an amendment to motion for summary judgment addressing a statute of limitations defense raised in petitioner's petition.[4]

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[4] On November 13, 1984, petitioner filed petitioner's reply to respondent's motion for summary judgment and amended motion for summary judgment. Petitioner's reply to respondent's amended motion for summary judgment contended that the statute of limitations had expired. On February 7, 1985, we summarily denied petitioner's above-referenced amended motion because where a false or fraudulent return with intent to evade any tax has been filed, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment at any time after such false or fraudulent return is filed. Estate of Temple v. Commissioner, 67 T.C. 143, 159-160 (1976); Harper v. (footnote continued)

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The case was called for trial on October 2, 1984, at which time the effect of Rule 90(c)--that the facts recited in respondent's requests for admission were deemed admitted--was confirmed by the Court since petitioner had failed to respond to them within 30 days of service.

Since the facts stated in the requests for admission had thus been deemed admitted, the Court denied on the grounds of mootness respondent's motion to compel responses to interrogatories and to compel the production of documents. Petitioner was given until November 1, 1984, to file an opening brief in response to respondent's motion for summary judgment, and respondent was given until December 3, 1984, to file a reply brief.

On November 13, 1984, petitioner filed a motion to dismiss with prejudice and motion for summary judgment on the ground that the deficiencies in issue were discharged in bankruptcy. At the same time petitioner also filed his "reply" to respondent's motion for summary judgment and amended motion for summary judgment asserting that assessment and collection of the deficiencies were barred because the period of limitations had not been extended by petitioner. This document, had it been a brief, was out of time by 12 days, but was nevertheless accepted and filed by the Court. Petitioner also submitted the document

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(footnote continued from previous page)
Commissioner, 54 T.C. 1121, 1142 (1970); section 6501(c)(1). We note that irrespective of section 6501(c)(1) respondent has presented valid extensions.

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which was filed by the Court as a motion to enlarge the time for responding to respondent's requests for admission and within which to respond to respondent's interrogatories. Perplexed by the possibility raised by an affidavit filed by petitioner implying that respondent had not properly mailed the requests for admission to petitioner on June 12, 1984, so that the 30-day period for response to the requests provided in Rule 90(c) had not commenced to run, the Court deemed an evidentiary hearing advisable.

The Evidentiary Hearing

The Court held the above-mentioned evidentiary hearing on February 26, 1985, in Chicago, Illinois, pursuant to the following order dated February 7, 1985:

> On June 15, 1984, respondent filed a First Request for Admissions, with exhibits attached. Petitioner having failed to respond to respondent's First Request for Admissions within 30 days after service of same, as provided by Rule 90(c), Tax Court Rules of Practice and Procedure, respondent on August 22, 1984, filed a Motion for Summary Judgment based upon the deemed admissions of the facts stated in the aforesaid First Request for Admissions.
>
> At a hearing held on October 2, 1984, at Chicago, Illinois, the Court ruled that the facts stated in respondent's First Request for Admissions were deemed admitted, and petitioner was granted 30 days from October 2, 1984, within which to argue the merits of the case in response to respondent's Motion for Summary Judgment.
>
> On November 13, 1984, petitioner filed a Motion to Dismiss With Prejudice and a Motion for Summary Judgment and submitted an affidavit of Susan J. Fasse averring that, as petitioner's employee, she retrieved respondent's First Request for Admissions from P. O. Box 13168, Atlanta, Georgia 30324, on September 4, 1984. She also averred that a portion of her job

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duties was to retrieve petitioner's daily mail from said post office box. The latter document was filed as a Motion to Enlarge Time for Request for Admissions and Reply to Interrogatories.

Respondent has filed the affidavit of Connie M. Willis averring that respondent's First Request for Admissions was mailed to petitioner at P. O. Box 13168, Atlanta, Georgia 30324, on June 12, 1984.

The premises considered, it is

ORDERED that this case is calendared for hearing at a Special Session commencing at 10:00 A.M. on February 26, 1985, in the United States Tax Court, Room 3908 Kluczynski Federal Building, 230 S. Dearborn Street, Chicago, Illinois 60604, for the purpose of determining when respondent's First Request for Admissions was mailed to petitioner. Receipt of evidence at said hearing will be limited to evidence relevant to such determination and on Petitioner's Motion to Enlarge Time for response to Request for Admissions and Replies to Interrogatories. It is further

ORDERED that this order shall be served on petitioner individually at P. O. Box 13168, Atlanta, Georgia 30324, at 5813 N. Imperial Drive, Peoria, Illinois 61602, and upon petitioner's counsel, Manning K. Leiter, Room 2300, 55 West Monroe Street, Chicago, Illinois 60603, and upon respondent. It is further

ORDERED that Petitioner's Motion to Dismiss With Prejudice and for Summary Judgment is denied.

This order constitutes official notice to the parties of said hearing.

Prior to the commencement of the hearing, a motion by Leiter to withdraw as petitioner's counsel was granted, and petitioner (as previously noted, himself an attorney) proceeded pro se.

Petitioner takes the position that, since he did not receive respondent's requests for admission until September 4, 1984, the 30-day period within which to respond as provided in Rule 90(c)

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had not expired as of the time the case was called for trial on the October 1, 1984, trial calendar. Conversely, respondent contends that the requests for admission were mailed and served on petitioner on June 12, 1984, and were mailed to the address furnished to respondent by petitioner. If the requests for admission were properly served by mail, petitioner would have had until July 13, 1984, to respond to the requests for admission.

At the hearing petitioner himself testified and he also presented the testimony of Susan J. Fasse, the person whose affidavit was filed by the Court as a motion to enlarge the time within which to respond to respondent's requests for admission. Petitioner also introduced numerous exhibits.

Respondent presented the testimony of Connie M. Willis, whose affidavit was filed by respondent in opposition to the affidavit of Fasse, and the testimony of Frank Agostino, respondent's attorney on each of the disputed dates. Respondent also introduced certain documents and called Leiter as a witness.

Susan J. Fasse testifed as follows:

At the time of the hearing she was approximately 37 years of age and resided at 383 East Wesley Road, NE, Atlanta, Georgia. She was employed by petitioner as a "paralegal administrator" in Peoria, Illinois, from January 1983, to September, 1983, at which time she moved to Atlanta. Commencing in October, 1983, and continuing until July, 1984, she worked part-time for Davison's Department Store in Atlanta.

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Petitioner lived in Fasse's house at 383 East Wesley Road in Atlanta from January, 1984, to sometime in August, 1984. During that time he also utilized space located on the ground floor of the house as office space. Petitioner was away from Atlanta from about June 1 to June 20, 1984.

Fasse also worked part-time as a secretary, paralegal and investigator for petitioner, and also assisted him in a cable TV venture, from January, 1984, to May 26, 1984, on which date Fasse's grandmother died in Illinois. Fasse was with her mother in Delavan, Illinois, until June 6, 1984, when she flew back to Atlanta. She remained in Atlanta until August 7, 1984, when she flew back to Peoria to help her mother clean out her late grandmother's house in Delavan. On August 30, 1984, she returned to Atlanta.

Fasse rented P. O. Box 13168, Atlanta, Georgia 30324, on November 29, 1983. The application for post office box, which petitioner introduced into evidence, indicates that Susan J. Fasse, Thomas V. Cassidy and David Vincent were authorized to receive mail addressed to the box. Fasse testified that "David Vincent" is petitioner's television stage name. Fasse and petitioner continued to hold the box throughout the relevant time period involved in this inquiry. According to her testimony she checked the box on a daily basis except Sundays from June 6, 1984, to the end of that month, and did not receive any mail from the "Director of Internal Revenue from Springfield, Illinois,

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during the month of June of 1984." She also testified that she checked the box daily except Sundays throughout July, 1984, and received no mail "from the Springfield office of the Internal Revenue Service during the month of July." Fasse was away from Atlanta from August 7 to August 30 but she resumed checking the box on her return.

On September 4, 1984, petitioner and Fasse drove in her car to the post office where the box was located and while petitioner waited in the car Fasse went in to check the mail. She brought an envelope to petitioner which she opened in the car in petitioner's presence. The envelope, which was introduced into evidence, was an ordinary letter-sized envelope, 4-1/4 by 9-1/2 inches. According to Fasse it contained respondent's first requests for admission, respondent's second set of interrogatories to petitioner and respondent's second request for production of documents. The envelope is postmarked Springfield, Illinois, August 31, 1984. It shows no evidence of having been stuffed with a large packet of documents.

Fasse explained the presence of three sets of holes in petitioner's copy of the requests, including one relatively large set of holes, indicating removed staples as being due to the fact that she took the document apart to copy it and then stapled it back together again, thereby increasing the size of the original holes.

Connie M. Willis testified as follows:

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Between August, 1978, and January, 1985, Connie Willis was the secretary to the District Counsel, Internal Revenue Service, Springfield, Illinois. Her duties included managing and supervising the general clerical routine and the clerial staff of the office, devising and installing office clerical procedures and instructing secretarial and clerical personnel with respect to such procedures. She reviewed all outgoing mail to ensure that it conformed to established policy of the Office of Chief Counsel.

Respondent's office mailing procedures require that all correspondence be mailed on the same day it is dated. Further, all correspondence sent via certified mail is logged into the certified mail book and then taken to the Post Office on the same day it is dated by employees of respondent.

Mail goes out of respondent's Springfield office in one of two-sized envelopes. The first, an ordinary letter-sized envelope, 4-1/4 by 9-1/2 inches, is utilized for short letters and correspondence of three pages or less. The second, a 9-1/2 by 12-1/4 inch envelope, is generally utilized for mailings in excess of three pages. All requests for admission, motions for summary judgment and all other extensive pleadings are mailed in a 9-1/2 by 12-1/4 inch envelope.

According to respondent's office records, respondent's first requests for admission, respondent's second request for production of documents and respondent's second set of

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interrogatories were mailed to petitioner at P.O. Box 13168, Atlanta, Georgia 30324, by certified mail on June 12, 1984. A copy of a page from respondent's certified mail book indicating that a package was mailed to petitioner via certified mail on June 12, 1984, was submitted in evidence. The June 12, 1984, postal stamp date was applied to the certified mail book by a United States postal employee. The documents, consisting of 50 pages in total, were mailed in a 9-1/2 by 12-1/4 inch envelope. Respondent's office records also show that a copy of a one-page letter mailed to this Court was sent to petitioner on August 31, 1984.

There was additional testimony taken at the hearing which in substance was duplicative of the respective positions illustrated by the testimony of Fasse and Willis. Although we find it unnecessary to reconstruct the additional testimony here, we emphasize that careful consideration was given to the testimony of each witness.

After examination of all the testimony, with particular attention being paid to the demeanor and consistency (or lack thereof) of the testimony of the witnesses, as well as the physical evidence before the Court, we conclude that respondent mailed the requests for admission to petitioner on June 12, 1984. Our conclusion is based first on the uncontroverted fact that

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petitioner received respondent's first requests for admission, respondent's second request for production of documents and respondent's second set of interrogatories.

Petitioner claims that these documents were received in a 4-1/4 by 9-1/2 inch envelope postmarked August 31, 1984. To support his contention, petitioner introduced the above-mentioned envelope and the documents so received. However, the documents introduced by petitioner, consisting of 18 pages, are missing exhibits "A" and "B," an additional 32 pages. Respondent's office records show that the entire 50 pages were sent to petitioner on June 12, 1984. Respondent's records also show that petitioner was sent a copy of a one-page letter on August 31, 1984. Moreover, respondent's office procedure would have required the 50 pages to be sent in a 9-1/2 by 12-1/4 inch envelope. Furthermore, the sheer volume of pages involved would have physically required a large envelope; i.e., larger than a 4-1/4 by 9-1/2 inch envelope.

Petitioner's argument, although elaborately constructed, necessarily crumbles when subjected to close scrutiny. It appears obvious that petitioner and Fasse, having recognized the physical implausibilities of their story, removed the attached exhibits, thereby reducing the total number of pages by 32. However, the documents they received by their own admission contained 18 pages, well over a number that could reasonably be expected to be mailed in a business letter-sized envelope without

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the envelope (which was viewed by the Court) manifesting some evidence of having been stuffed with 18 pieces of paper. This envelope did not.

In addition, the Court observed that at one time the request was stapled with an over-sized staple, the kind that would be necessary to staple 50 pages. Fasse's explanation for the over-sized staple holes, that several staplings near the same area could have caused the holes, is implausible.

The more plausible explanation is that petitioner and Fasse fabricated their testimony in an effort to avoid the consequences of petitioner's continued deliberate disregard for his responsibilities in connection with this case, including his disregard for the requirement of Rule 90(c) that requests for admission are to be answered within 30 days. Petitioner made no response at all to the request until well after the unfortunate consequences of his "stonewalling" approach came home to him at the Court's sessions in Chicago on October 1 and 2, 1984.

We think the evidence is totally convincing that respondent properly mailed and served the requests for admission to petitioner on June 12, 1984, and we so find. Having determined that respondent's first requests for admission were mailed to petitioner on June 12, 1984, we now proceed to rule on the pending motions.

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Motion for Extension of Time

Rule 21(b) provides in general that service of all papers other than the petition made by mail directed to the party or his counsel at his last known address shall be complete upon mailing and the date of mailing is to be the date of service. Consequently, petitioner was served with respondent's first requests for admission on June 12, 1984.

Under Rule 90(c), each request for admission is deemed admitted unless an answer is served on the requesting party "within 30 days after service of the request * * * ." The Court, in its discretion, may allow a party more than 30 days to respond. However, a motion to extend the time to file responses must be made prior to the expiration of 30 days following service of the requests. Morrison v. Commissioner, 81 T.C. 644, 646-647 (1983). If no motion is filed within this time period, each request is automatically deemed admitted without the entry of any order by the Court. 81 T.C. at 647.

In the instant case, respondent's requests for admission were served on petitioner on June 12, 1984. Each request contained therein was therefore deemed admitted on July 13, 1984.[5] Rule 90(c); Dahlstrom v. Commissioner, 85 T.C. 812 (1985); Freedson v. Commissioner, 65 T.C. 333, 334-336 (1975),

[5] Rule 90(b) requires the original requests for admission to be filed with the Court along with a certificate of service. Rule 90(c), however, begins the 30-day time limit for responding from time of service which is the time of mailing pursuant to Rule 21(b).

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565 F.2d 954 (5th Cir. 1978). Accordingly, petitioner's motion for extension of time to answer requests for admission filed on November 13, 1984, is untimely and is denied.

Motion to Withdraw Admissions

Under Rule 90(e) an admission may be withdrawn or modified (1) if the withdrawal or modification would subserve the presentation of the merits of the case and (2) if the party obtaining the admission "fails to satisfy the Court that the withdrawal or modification will prejudice him in prosecuting his case or defense on the merits." As already substantively demonstrated, petitioner has consistently ignored all of respondent's discovery and stipulation efforts in flagrant violation of the Rules of this Court. At least one reasonable inference which may justifiably be drawn from this course of conduct is that the facts, if disclosed, would not support petitioner's position herein. It is therefore implausible to assume that the withdrawal of the deemed admissions would subserve the presentation of the merits of the case--the first criteria of Rule 90(e).

As to the second criteria, it has been convincingly demonstrated that the withdrawal of the admissions would prejudice respondent in presenting his case on the merits. In Morrison v. Commissioner, supra at 649, we stated that "[a] party

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will be prejudiced by the withdrawal of admissions if he has relied on them and will suffer delay, added expense, and additional effort because of the withdrawal."

Here, respondent has relied in good faith on the binding effect of the deemed admissions to prepare his motion for summary judgment. Moreover, as revealed by the entire six-year history of this case, respondent has made repeated good faith efforts to comply with the Court's Rules regarding preparation for trial. Petitioner, on the other hand, has consistently attempted to thwart those efforts. Each and every attempt by respondent to move this case forward has been met by aggravated dilatory tactics on the part of petitioner. Failing to respond to the requests for admission is only one example of petitioner's many actions, deliberate and culpably negligent, resulting in the obstruction and delay of the resolution of this case.

Petitioner made no suggestion prior to the time respondent filed his motion for summary judgment that he intended to file a motion to withdraw his deemed admissions. In fact, petitioner's filing of the Fasse affidavit on November 13, 1984, was deemed to be a motion to withdraw the deemed admissions only because the Court characterized it as such. The motion, such as it was, was filed four months after the admissions were deemed admitted and more than two and one-half months after respondent had filed his motion for summary judgment. See Dahlstrom v. Commissioner, 85 T.C. 812 (1985) (motion by taxpayers to withdraw admissions,

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filed two months after they were deemed admitted and one month after Commissioner's summary judgment motion was filed, denied). Thus, because respondent relied in good faith on petitioner's failure to reply or object to the requested admissions, withdrawal of the deemed admissions would result in undue prejudice to respondent's presentation of this case. Morrison v. Commissioner, supra.

Moreover, withdrawal of the admissions would cause further delay of this case, which when measured against any conceivable benchmark has already been unduly prolonged. We believe petitioner will continue to pursue his dilatory methods if respondent is required to again prove at trial the facts now deemed to be admitted. Accordingly, as we found in Morrison v. Commissioner, supra at 650, when "we weigh our interest in diligence of litigation and the prejudice to respondent against petitioners' desire for a trial on the merits, the scales fall far on the side of respondent." Consequently, petitioner's motion to withdraw deemed admissions is denied.

Motion for Summary Judgment

Under Rule 121, a summary adjudication may be made "if the pleadings, answers to interrogatories, depositions, admissions, and any other acceptable materials, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that a decision may be rendered as a matter of law." Rule 121(b). The party opposing the motion cannot rest upon the

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allegations or denials in his pleadings, but must "set forth specific facts showing that there is a genuine issue for trial." Rule 121(d). The moving party, however, bears the burden of proving that there is no genuine issue of material fact, and factual inferences will be read in a manner most favorable to the party opposing summary judgment. Jacklin v. Commissioner, 79 T.C. 340, 344 (1982); Espinoza v. Commissioner, 78 T.C. 412, 416 (1982).

Respondent takes the position that the facts deemed admitted under Rule 90(c) are sufficient to sustain his deficiency determination as well as satisfy his burden of affirmatively proving fraud. Petitioner, although given the opportunity to respond to respondent's motion, has failed to raise any argument in opposition to respondent's motion other than those based on the two motions previously decided adversely to petitioner. Nevertheless, we proceed in light of the admissions before us to determine their sufficiency for purposes of summary judgment.

The following facts are deemed admitted for purposes of this case:

> 1. The copies of income tax returns attached to respondent's request for admissions and marked as Exhibits A and B, respectively, are true and correct copies of the Federal income tax returns filed by petitioner for the taxable years ended August 31, 1974 and August 31, 1975 (hereinafter sometimes referred to as the 1974 and 1975 returns, respectively).
>
> 2. During the taxable years ended August 31, 1974 and August 31, 1975, petitioner received legal fees of $14,586.00 and $32,875.00, respectively, that were not reported on his Federal income tax returns for those years.

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3. During the years ended August 31, 1974 and August 31, 1975, petitioner was not entitled to claim depreciation on his personal automobile in excess of that allowed by respondent in the notice of deficiency.

4. During the year ended August 31, 1974, none of the $100.00 claimed by petitioner to have been paid to the Central Illinois Racquet Club was expended for the purpose designated.

5. Expenses claimed to have been paid to the Central Illinois Racquet Club were personal in nature and not ordinary and necessary business expenses.

6. Petitioner did not incur more than $1,346.00 and $3,010.00 in the years ended August 31, 1974 and August 31, 1975, respectively, in deductible travel and entertainment expenses.

7. None of the "travel and entertainment" expenses claimed by petitioner in excess of that allowed by respondent in the notice of deficiency on his 1974 and 1975 returns were expended for the purpose designated.

8. The travel and entertainment expenses claimed by petitioner in excess of that allowed by respondent in the notice of deficiency on his 1974 and 1975 returns were personal expenses of petitioner and not ordinary and necessary business expenses.

9. Petitioner used entirely for his own benefit all monies claimed expended on travel and entertainment expenses during the years 1974 and 1975.

10. None of the $1,288.00 claimed by petitioner on his 1975 return as business gifts was expended for the purposes designated.

11. None of the $1,288.00 claimed by petitioner as business gifts on his 1975 return qualified as ordinary and necessary business expenses.

12. Petitioner used entirely for his own benefit all monies claimed as business gifts.

13. Petitioner is unable to substantiate any of the expenses disallowed by respondent in his notice of deficiency.

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14. Petitioner knew at the time he filed his 1974 and 1975 income tax returns that he could not substantiate any of the disallowed deductions.

15. During the years 1974 and 1975, procedures set up by petitioner's accountants required petitioner's office personnel to deposit petitioner's legal fees into the law firm's bank account and post the income to an income ledger.

16. Petitioner caused the circumvention of these procedures by drawing advances against his legal fees.

17. Petitioner knew that these advances were not picked up by his bookkeeper and that these advances would not subsequently be posted to an income ledger.

18. Petitioner unlawfully withdrew money from his professional trust account.

19. Petitioner retained sole authority to sign checks on his business bank accounts.

20. Petitioner was continuously aware of receiving legal fees in excess of those reported on his income tax returns.

21. Petitioner fraudulently and with intent to evade taxes omitted from his income tax returns for the taxable years ended August 31, 1974 and August 31, 1975, a substantial portion of his gross income.

Based on the foregoing deemed admissions, we find that respondent has satisfied his burden of proving that no genuine issue of material fact exists as to respondent's underlying deficiency determination and that respondent is entitled to a decision with respect to his underlying deficiency determination as a matter of law. Marshall v. Commissioner, 85 T.C. 267 (1985). In addition, for the following reasons, we find that respondent has satisfied his burden with respect to the additions to tax for fraud under section 6653(b).

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Fraud is defined as an intentional wrongdoing designed to evade tax believed to be owing. Professional Services v. Commissioner, 79 T.C. 888, 930 (1982). The burden of proof rests on respondent to show by clear and convincing evidence that some portion of the understatement of income for each year was due to fraud with the intent to evade tax. Miller v. Commissioner, 51 T.C. 915 (1969); section 7454(a); Rule 142(b). Respondent must establish (1) that petitioner underpaid his taxes during each year and (2) that some part of petitioner's underpayment each year was due to fraud. Hebrank v. Commissioner, 81 T.C. 640, 642 (1983).

Petitioner is deemed to have admitted facts which overwhelmingly establish substantial, intentional omissions of taxable income. Likewise, the admissions are repleat with the requisite indicia of fraud. Marshall v. Commissioner, supra; Doncaster v. Commissioner, 77 T.C. 334 (1981). Specifically, petitioner has admitted to not reporting substantial amounts of income and that he purposefully circumvented procedures set up by his accountants to accomplish this reporting omission. In addition, petitioner admitted to claiming non-existent deductions and business expenses which were in fact expenditures for his personal benefit. We note that our conclusion is buttressed by petitioner's dilatory tactics throughout the prosecution of this case as well as his deliberate attempt to circumvent the consequences of his actions by way of fabricated testimony. We

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therefore find that the facts deemed admitted under Rule 90(c) are sufficient to satisfy respondent's burden of proving that some portion of the understatement of income was due to fraud with the intent to evade tax. Marshall v. Commissioner, supra.

Accordingly, respondent's motion for summary judgment is granted as to the deficiencies and additions to tax for fraud in the amounts stated.

An appropriate order and decision will be entered.

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T. C. Memo. 1986-134

UNITED STATES TAX COURT

SUSIE SCHUSTER a/k/a SUSIE SCHUSTER TRANSLATEUR, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 32011-84. Filed April 3, 1986.

Held, the statutory notice of deficiency was mailed to petitioner's last known address. The Commissioner's motion to dismiss for lack of jurisdiction is granted.

Jorge Rodriguez-Chomat, for the petitioner.

Irene Scott Carroll, for the respondent.

MEMORANDUM OPINION

NIMS, Judge: Respondent has moved for the dismissal of this case due to lack of jurisdiction premised upon the ground that the petition was not filed within 90 days of the mailing of the

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statutory notice of deficiency as required by section 6213(a).[1] Petitioner admits that her petition was filed 454 days after the notice was mailed, but counters that respondent did not send the notice to petitioner's last known address as required by section 6212, and further that the petition was filed within 90 days after petitioner received actual notice of the existence of the statutory notice.

The petition, which was filed in this Court on September 10, 1984, recites that "[t]he petitioner is an individual, citizen of the Republic of Colombia, South America, who until on or about June 15, 1982 resided in the United States under a student visa in an apartment in Dade County, Florida owned by her parents." The petition contains no further information as to petitioner's place of residence as of the date on which the petition was filed. The record contains no evidence as to petitioner's whereabouts or place of residence either on the date on which the petition was filed or March 11, 1985, the date on which an evidentiary hearing was conducted by this Court in connection with respondent's motion.

Some of the facts have been stipulated and are so found. The stipulation of facts and attached exhibits are incorporated herein by reference.

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954 in effect for the time in question.

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Before the end of 1980, petitioner entered the United States on a student visa. Petitioner attended Miami Dade Community College. She lived at 1925 Brickell Avenue, Apt. D1501, Miami, Florida 33129, from the end of 1980 until sometime in June, 1982.

During 1981, Samuel Schuster, petitioner's brother, entered the United States on a student visa and lived at the Brickell Avenue address until after his conviction for currency violations sometime after October 1, 1983.

The Brickell Avenue property is a condominium apartment purchased by Jose and Hilda Schuster, the parents of petitioner and Samuel Schuster, in the latter part of 1980. As of the date of the above-mentioned evidentiary hearing the Brickell Avenue condominium continued to be owned by Jose and Hilda Schuster.

Petitioner married Eduardo Translateur sometime during the month of June, 1982.

On June 24, 1982, petitioner was indicted by a Federal grand jury in Los Angeles, California, which indictment was made public on or about June 30, 1982.

On June 30, 1982, the Los Angeles District Director of Internal Revenue terminated petitioner's 1982 income tax year under section 6851 and assessed an income tax in the amount of $1,250,662.40. The "notice of termination assessment of income tax" was mailed to petitioner at the Brickell Avenue address. The taxable period was stated to be January 1, 1982, through

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June 30, 1982. On September 21, 1982, in response to the notice of termination assessment, a "petition for determination to review the jeopardy (termination) assessment" was filed on behalf of petitioner in the United States District Court for the Southern District of Florida. Raymond J. Takiff (Takiff) was the original attorney of record in that proceeding.

Sometime between June 29, 1982, and July 2, 1982, the Brickell Avenue apartment was searched by Federal agents, including one or more Internal Revenue Service special agents and one or more Drug Enforcement Administration agents. One of the items taken during this search was an itinerary prepared for an unnamed person or persons, which itinerary itemizes a trip commencing in Miami on June 19, 1982, and terminating in Miami on August 4 of the same year.

Petitioner was arrested in Auckland, New Zealand, on July 2, 1982,[2] because of her indictment in the United States. The aforementioned itinerary reveals that the unnamed person or persons for whom it was prepared was or were scheduled to travel from Melbourne to Auckland on June 30 and to depart from Auckland for Sidney on July 2.

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[2] The parties stipulated that petitioner was arrested on July 3, 1982. However, in a copy of an appellate brief (allegedly filed in another case) attached by petitioner to her petition in this case, at page 7 it is stated that petitioner was arrested on July 2, 1982, as she was about to board a flight at the Auckland airport. The July 2 date is consistent with the date of scheduled departure from Auckland shown in the itinerary.

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Internal Revenue Service personnel became aware of the above-mentioned itinerary and the fact that petitioner was under arrest in Auckland, New Zealand, on or about July 6, 1982.

At no time has petitioner filed any United States income tax returns.

Following her arrest by New Zealand, petitioner successfully resisted extradition efforts by the United States and was released from jail in Auckland, New Zealand, on November 12, 1982.

On or about August 11, 1982, the Internal Revenue Service received a copy of a letter from Takiff addressed to Assistant United States Attorney Robert Perry. The letter proceeds upon the assumption that Takiff was representing "Susie or Sam Schuster" and protests the fact that "various assets in Miami and other places have been 'frozen' by the Internal Revenue Service, predicated in part by their [sic] belief that these accounts are owned by Sam and Susie Schuster and in part because they [sic] believe that these accounts have somehow violated Internal Revenue Service regulations and/or the laws of the United States of America." Takiff further states that "I have been authorized by my client to accept service of any process with respect to these bank accounts and invite that service be made for same either by mail from Los Angeles or from agents based in Miami." The letter also stated that Takiff received an IRS notice of levy

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against petitioner when "I went to the [Brickell Avenue] apartment, checked the mail, and found a levy addressed to her [petitioner]."

A copy of the aforementioned letter from Takiff to Perry came to the attention of Internal Revenue Service personnel in Los Angeles, and respondent's counsel, before the end of September, 1982.

The Internal Revenue Service, through a branch of the Jacksonville District Director's office located in Miami, Florida, received a copy of another letter from Takiff, this one dated August 20, 1982, and addressed to "Honorable Peter W. Lindsey, Representative of the District Director of Florida, Department of the Treasury, Internal Revenue Service, in which Takiff states that "Susie Schuster, by and through her undersigned attorney, hereby protests the determination made by the District Director of Florida, Internal Revenue Service, with regard to the taxpayer hereinabove noted and the wrongful levy of various bank accounts, which levy is in the amount of $1,250,662.40. This wrongful levy has resulted in a specific levy on certain bank accounts at the Royal Bank of Canada, the Eagle National Bank, and the Banco de Iberioamerica."

The office address of Takiff on both the July 29, 1982, and the August 20, 1982, letters is shown to be "Ponce de Leon Plaza, 201 Alhambra Circle, Suite 511, Coral Gables, Florida 33134."

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On June 1, 1983, the District Director in Los Angeles wrote to Takiff advising him that a power of attorney, Form 2848, must be in the Internal Revenue Service's files before "we can provide you with any correspondence concerning the examination of the tax liability of Susie Translateur, nee Schuster." A blank copy of the form was sent to Takiff for his convenience. On June 14, 1983, the Los Angeles District Director's office mailed a notice of deficiency to petitioner addressed to her at 1925 Brickell Avenue, Apt. D1501, Miami, Florida 33129. The statutory notice was sent by certified mail and was received on June 17, 1983, by "S. Schuster, 1929 Brickell 1501."

The deficiency notice involved petitioner's 1982 Federal income tax liability and determined an income tax deficiency in the amount of $1,253,068.00 and an addition to tax under section 6653(b) in the amount of $626,534.00.

Neither the notice of deficiency nor any copy of it was sent to Takiff in any capacity. The Internal Revenue Service was never informed that Takiff was not representing petitioner as her attorney. After November 12, 1982, when petitioner was released from the Auckland jail, the Internal Revenue Service did not know her whereabouts. On June 14, 1983, the date of the mailing of the statutory notice of deficiency, the Internal Revenue Service knew that Takiff was still petitioner's attorney of record in the section 7429 action before the United States District Court for the Southern District of Florida. The petition in this case was filed within 90 days from the filing date of the government's

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appellate brief in the section 7429 action. The appellate brief contains, in a footnote on page 16, a reference to the statutory notice of deficiency. Petitioner's counsel in this case before this Court alleges that he first became aware of the existence of the deficiency notice when he read the appellate brief.

As previously stated, the petition was filed in the Tax Court on September 10, 1984, 454 days after the mailing of the statutory notice of deficiency. It is not entirely clear whether petitioner is arguing that the Court has jurisdiction because the petition was filed within 90 days after petitioner received actual notice of the statutory notice of deficiency or that the Court does not have jurisdiction because the deficiency notice was not mailed to petitioner's last known address as required by section 6212(b)(1). In either case, for reasons hereinafter stated, we find that the deficiency notice was mailed to petitioner's last known address and therefore that the petition was not timely filed.

In order to set the scene for the last known address discussion which follows, we deem it advisable to review briefly the context in which the deficiency notice was issued. Respondent represents on brief that the deficiency notice was mailed to petitioner in order to validate the termination assessment made pursuant to section 6851. The rule in the Ninth Circuit as announced in Perlowin v. Sassi, 711 F.2d 910 (9th Cir. 1983), reversing and remanding on another issue 544 F.Supp. 89 (N.D. Cal. 1982), requires the issuance of a statutory notice

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pursuant to the provisions of section 6851(b), even though the taxpayer did not file a return for the complete taxable year encompassing the period for which the termination assessment was made. As stated by the district court in a comprehensive opinion by Chief Judge Peckham of the Northern District of California, "[t]he statute thus assumes that the taxpayer will file a tax return. If the taxpayer does not file a return, the statute is ambiguous as to whether and when the [Revenue] Service must send a notice of deficiency." (Emphasis in text.) 544 F.Supp. at 91. In Perlowin v. Sassi, the district court enjoined a termination assessment since the Internal Revenue Service never sent the taxpayer a deficiency notice for the full tax year involved. (The Ninth Circuit remanded so that the District Court could determine whether the taxpayer was irreparably harmed by the seizure of assets and whether the taxpayer had no adequate legal remedy.) Respondent represents that the statutory notice in this case was issued to forestall the possibility of similar action being taken as to the termination assessment against petitioner.

The deficiency notice was mailed to petitioner on June 14, 1983, which was 60 days from the due date of petitioner's return for 1982. This meets the requirements of section 6851(b) as interpreted by Perlowin v. Sassi, supra.[3] The mailing date of

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[3] Section 6851(b) provides:

> (b) NOTICE OF DEFICIENCY.--If an assessment of tax is made under the authority of subsection (a), the Secretary shall mail a notice under section 6212(a) for the taxpayer's full taxable year (determined

(footnote continued)

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the deficiency notice was within 60 days of the due date of a return for petitioner's 1982 tax year, but petitioner filed no return.

As of June 14, 1983, petitioner had long since been released from the Auckland jail--which event took place on November 12, 1982. This was a fact of which the Internal Revenue Service was well aware. It would therefore have been bootless for the Revenue Service to address the deficiency notice to petitioner at the Auckland jail. On the other hand, the Brickell Avenue apartment, owned by petitioner's parents, was the place where she had resided for a considerable period of time while registered as a student at the Dade Community College and the place to which she apparently intended to return if the itinerary which the parties stipulated into evidence is to be believed. It was also the place where on at least one occasion Takiff picked up petitioner's mail.

Petitioner argues that if the Auckland jail was not petitioner's last known address then Takiff's office was petitioner's last known address since the government was on notice that Takiff was representing petitioner in the termination assessment proceedings before the United States District Court.

(footnote continued from previous page)
without regard to any action taken under subsection (a)) with respect to which such assessment was made within 60 days after the later of (i) the due date of the taxpayer's return for such taxable year (determined with regard to any extensions), or (ii) the date such taxpayer files such return. Such deficiency may be in an amount greater or less than the amount assessed under subsection (a).

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However, at no time did petitioner herself notify the Internal Revenue Service that Takiff's office was the address to which she wished to have correspondence addressed, and Takiff never filed a power of attorney executed by petitioner although given an opportunity to do so.

Petitioner at no time subsequent to her release from the Auckland jail has revealed her whereabouts either to respondent or to this Court.

While it might be argued that respondent could have, in an excess of caution, mailed a copy of the deficiency notice to Takiff, such action was no doubt forestalled by the lack of a properly executed power of attorney. Further prompt acceptance of the deficiency notice, on June 17, 1983, by someone at the Brickell Avenue apartment who signed himself or herself as "S. Schuster" showed that the notice was received in due course. The Internal Revenue Service had every right to assume that the deficiency notice had been delivered, and there was no need to look further for a recipient on petitioner's behalf.

Although the Code does not address itself to what constitutes a taxpayer's last known address, we have consistently held that the last known address is the taxpayer's last permanent address or legal residence known by the Commissioner or the last known temporary address of a definite duration to which the taxpayer has directed the Commissioner to send all communications. Alta Sierra Vista v. Commissioner, 62 T.C. 367, 374 (1974), affd. without published opinion 538 F.2d 334 (9th Cir.

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1976). As we said in Alta Sierra Vista, "[t]he relevant inquiry pertains to the Commissioner's knowledge rather than to what may in fact be the taxpayer's most current address in use. Administrative realities demand that the burden fall upon the taxpayer to keep the Commissioner informed as to his proper address." 62 T.C. at 374. As already emphasized, petitioner's course of conduct in this case has been to keep the Commissioner in the dark rather than to enlighten him as to her, petitioner's, last known address.

Without question, a taxpayer may notify the Commissioner that a place of incarceration is the address to which the taxpayer wishes correspondence to be sent. See DiViaio v. Commissioner, 539 F.2d 231 (D.C. Cir. 1976), reversing an unpublished order of this Court dismissing a petition on jurisdictional grounds. Nevertheless, unless respondent is specifically so notified by the taxpayer, there is no requirement that a deficiency notice be sent to a place of temporary sojourn, such as a jail. Cohen v. United States, 297 F.2d 760 (9th Cir. 1962). In this case, even petitioner admits that the Auckland jail was not her place of residence on June 14, 1983, nor can it be argued that her residence as such in the Auckland jail was expected by her to be anything more than temporary and of an indefinite duration. Furthermore, respondent could not have sent petitioner a deficiency notice while she was in the Auckland jail since the 1982 taxable year had not ended prior to the date of her release.

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While we have held that the Commissioner is bound to exercise reasonable diligence in ascertaining the taxpayer's correct address, Alta Sierra Vista v. Commissioner, supra, at 374, we think the Commissioner exercised such diligence in this case. Respondent's agent, Evans, who participated in the issuance of the termination assessment and the subsequent deficiency notice, testified that he checked the Internal Revenue Service's computer to determine whether tax returns, including a return for 1982, had been filed by petitioner. Such returns might have disclosed a different address than the Brickell Avenue apartment, but petitioner did not, as previously stated, file any such returns. According to Evans, whose testimony we found credible, the computer merely revealed the Brickell Avenue address to which the notice of termination assessment was sent.

Evans also testified that he checked with the special agents who had been involved in a criminal investigation regarding petitioner. Evans testified that "[t]he only thing I could come up with was the same address that we had when the original notice of termination had been sent out, which was an address in Miami Beach." He also testified that this was the Brickell Avenue address. We therefore think respondent has demonstrated due diligence in ascertaining petitioner's last known address.

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For the foregoing reasons, we hold that respondent has met the requirement of section 6212(b) that a statutory notice be mailed to petitioner's last known address, and that the petition is untimely so as to require the dismissal of this case for lack of jurisdiction.

An appropriate order will be entered.

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T. C. Memo. 1986-135

UNITED STATES TAX COURT

JAIME AND BERTHA BENREY, Petitioners
v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 30583-85. Filed April 7, 1986.

207 days after the mailing of the notice of deficiency, the Court received an "Amended Petition" which was filed as a petition. Ps maintain that an original petition was timely mailed to the Court by ordinary mail 8 days before the expiration of the 90-day period for filing a petition. In response to R's Motion to Dismiss for Lack of Jurisdiction, Ps argue they are entitled to a presumption that the original petition was received by the Court in the ordinary course of mail.

Held, Ps are not entitled to a presumption that the original petition was received by the Court. Accordingly, Ps failed to prove that the original petition was timely filed. R's Motion is granted.

Robert D. Grossman, Jr.,[1] for the petitioners.

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[1] Mr. Grossman, while admitted to practice before this Court, has not filed an entry of appearance. However, he was recognized specially for the purpose of presenting argument respecting respondent's motion.

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David H. Peck and Will E. McLeod, for the respondent.

MEMORANDUM OPINION

DRENNEN, Judge: Respondent's Motion to Dismiss for Lack of Jurisdiction filed herein was assigned to Special Trial Judge Francis J. Cantrel for hearing, consideration and ruling thereon.[2] After a review of the record, we agree with and adopt his opinion which is set forth below.

OPINION OF THE SPECIAL TRIAL JUDGE

CANTREL, Special Trial Judge: This case is before the Court on respondent's Motion to Dismiss for Lack of Jurisdiction filed on October 25, 1985. Respondent seeks dismissal on the ground that the petition was not filed within the time prescribed by section 6213(a) or 7502.[3]

Respondent, in his notice of deficiency issued to petitioners on January 10, 1985, determined a deficiency in petitioners' Federal income tax and additions to the tax for the taxable calendar year 1981 in the following respective amounts:

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[2] This case was assigned pursuant to sec. 7456(d)(4), Internal Revenue Code of 1954, as amended, and Rule 180, Tax Court Rules of Practice and Procedure.

[3] All section references are to the Internal Revenue Code of 1954, as amended.

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Year	Income Tax	Additions to Tax, I.R.C. 1954 Section 6653(a)(1)	Section 6653(a)(2)
1981	$37,750.00	$1,887.50	50% of the interest due on $37,750.00

The record is clear that respondent mailed the notice of deficiency on January 10, 1985 by U.S. certified mail (No. 16853) to petitioners at their last known address pursuant to section 6212.

Section 6213(a), which permits the filing of petitions with this Court, provides in part:

> Within 90 days * * * after the notice of deficiency authorized in section 6212 is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the last day), the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency. * * *

The 90th day after the mailing of the notice of deficiency was Wednesday, April 10, 1985, which date was not a legal holiday in the District of Columbia. On August 5, 1985, 207 days after the mailing of the notice of deficiency, the Court received a document entitled "Amended Petition" which was filed by the Court on that same day as petitioners' petition. The cover in which the petition was received is postmarked August 2, 1985, 204 days after the mailing of the notice of deficiency. The petition states, in pertinent part:

> The petitioners hereby amend their petition filed in the above-entitled case on April 2, 1985 by alleging as follows:
>
> 1. On April 2, 1985, the original and three conformed copies of a petition from the respondent's notice of deficiency dated January 10, 1985 were timely mailed to the Clerk of Court. * * *

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2. On information and belief, the Clerk's office has no record of receipt of the petition filed on April 2, 1985.[4]

A search of the Court's records revealed that the April 2, 1985 petition (original petition) has not been filed with the Court nor was there any record of its receipt.

Petitioners filed a Notice of Objection on November 14, 1985 wherein they opposed respondent's motion on the basis that a petition was mailed on April 2, 1985, 8 days before the expiration of the 90-day period for filing a petition with the Court. It is petitioners' position that they are entitled to a presumption that letters deposited in the United States mails will be received by the addressee in due course.

A hearing on respondent's motion was conducted in Washington, D.C. on December 18, 1985, at which time counsel for the parties appeared and presented argument. Petitioners' counsel of record, who prepared and signed both petitions, his secretary, and the law firm's accountant testified at the hearing. Their testimony was offered to establish:

1 - that a petition was prepared on April 2, 1985,

2 - that a check payable to the Tax Court was prepared on April 2, 1985,

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[4] Attached to the petition are copies of the original petition dated April 2, 1985, a Place of Trial Designation dated April 2, 1985, and a transmittal letter directed to the Clerk of Court dated April 2, 1985. (Exhibits A-C, respectively.)

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3 - that the petition and check were mailed to the Tax Court on April 2, 1985, and

4 - that neither the petition nor the check have been returned to the law firm.

Petitioners argue that by virtue of the uncontradicted testimony presented to the Court they are entitled to a presumption that the petition was received by the Court in due course.

Respondent, by and through his motion and at the hearing at Washington, D.C. on December 18, 1985, urges that we dismiss this case on the ground that the petition, entitled "Amended Petition," was received and filed 207 days after the mailing of the notice of deficiency. With respect to the earlier petition dated April 2, 1985, respondent argues that filing occurs on the physical delivery of the document unless petitioners come within the protection afforded under section 7502. At the conclusion of the hearing, the motion was taken under advisement.

The burden of proving that this Court has jurisdiction is upon petitioners. Cassell v. Commissioner, 72 T.C. 313, 317-318 (1979); Harold Patz Trust v. Commissioner, 69 T.C. 497, 503 (1977), and cases cited therein.

A petition for redetermination of a deficiency must be filed with this Court within 90 days, or 150 days if the notice is addressed to a person outside the United States, after the notice of deficiency is mailed to a taxpayer. Section 6213. The time

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provided for the filing of a petition with this Court is jurisdictional and cannot be extended. Failure to file within the prescribed period requires that the petition be dismissed for lack of jurisdiction. Blank v. Commissioner, 76 T.C. 400, 403 (1981); Estate of Rosenberg v. Commissioner, 73 T.C. 1014, 1016-1017 (1980); Estate of Cerrito v. Commissioner, 73 T.C. 896, 898 (1980); Stone v. Commissioner, 73 T.C. 617, 618 (1980); Estate of Moffat v. Commissioner, 46 T.C. 499, 501 (1966).

Filing is completed when the petition is received by the Court, unless the exception provided in section 7502 applies. Sylvan v. Commissioner, 65 T.C. 548, 550 (1975). Congress enacted section 7502 to alleviate the hardships resulting from the failure of the mail to function properly, i.e., alleviate hardships resulting from variations in postal performance when a document is timely mailed. Sylvan v. Commissioner, supra at 551.

Section 7502(a) provides as a general rule that if the petition is delivered to the Tax Court by United States mail in an envelope properly addressed, postage prepaid "the date of the United States postmark stamped on the cover" in which such petition is mailed "shall be deemed to be the date of delivery" of the petition to the Court, and hence the filing date. The provisions of section 7502(a) are applicable, however, only if the petition is delivered to the Court. Section 301.7502-1(d)(1), Proced. & Admin. Regs. See Deutsch v. Commissioner, 599 F.2d 44, 46 (2d Cir. 1979), affg. an order of dismissal by this

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Court, cert. denied 444 U.S. 1015 (1980).[5] But, in the case of a petition sent by U.S. registered mail or certified mail, section 7502(c) and section 301.7502-1(d)(1), Proced. & Admin. Regs., establish that actual delivery is not a requirement when registered or certified mail is used, unlike the case when a document is sent by ordinary mail. See Storelli v. Commissioner, 86 T.C. ____ (filed March 24, 1986). However, where a taxpayer must rely on section 301.7502-1(d)(1), Proced. & Admin. Regs., to establish prima facie evidence that the petition was delivered by registered or certified mail, strict proof that the requirements of the regulations have been satisfied is necessary before the taxpayer is entitled to a presumption of delivery. See Storelli v. Commissioner, supra.

Petitioners attempt to prove delivery and timeliness without benefit of section 7502. It is petitioners' position that they are entitled to a presumption that the original petition mailed 8 days prior to the expiration of the 90-day period was received by the Court in the due course of the mail, and, because respondent did not introduce evidence to rebut that presumption, the original petition should be deemed timely filed under section 6213.

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[5] See also Foerster v. Commissioner, T.C. Memo. 1981-32; cf. Herrera v. Commissioner, T.C. Memo. 1984-47.

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Petitioners steered the Court away from the provisions of section 7502 since it is clear that neither the petition received by the Court on August 5, 1985 nor the original petition mailed on April 2, 1985 would be considered timely filed under the objective standards provided by that section. Nonetheless, and in spite of their creative argument, we are not persuaded that the original petition was timely filed under section 6213. We simply cannot agree that petitioners are entitled to a presumption of delivery.

Prior to the enactment of section 7502 courts often invoked a presumption of delivery in due course of the mails in order to mitigate the harsh inequities resulting from a literal adherence to the filing requirements of section 6213. See Wells Marine, Inc. v. Renegotiation Board, 54 T.C. 1189, 1191-1192 (1970), and cases cited therein. Recognizing the inequities and the uncertainty of the measures being taken by the courts to adjust them, Congress enacted section 7502 to alleviate the hardships resulting from the failure of the mail to function properly. See Sylvan v. Commissioner, supra at 557 (Drennen, J., dissenting); Wells Marine, Inc. v. Renegotiation Board, supra. In enacting section 7502 Congress provided a specific means by which a taxpayer could ensure proof of delivery and the timeliness of the petition. See section 7502(c) and the regulations thereunder which set forth the requirements for reliance on registered or certified mail in establishing prima facie evidence of delivery.

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Congress apparently considered the possibility that a petition properly mailed would not be received by the addressee. Had Congress intended that proof of ordinary mailing would constitute prima facie evidence of delivery, it would have so provided. Accordingly, the remedial provisions of section 7502(c) pertaining to prima facie evidence of delivery do not apply when a petition mailed by ordinary mail is not received by the Court.[6]

Petitioners advocate that section 7502 is not the exclusive exception to the literal language of section 6213 and that they are entitled to a presumption of delivery as invoked by courts prior to the enactment of section 7502. We disagree. As previously stated, for purposes of section 6213 a petition is filed on the date it is actually received, except that if the requirements of section 7502 are met, the petition shall be considered to be filed on the postmark date.[7] Because the original petition dated April 2, 1985 was not actually received by the Court, and because petitioners' have failed to satisfy the

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[6] See Deutsch v. Commissioner, 599 F.2d 44, 46 (2d Cir. 1979), affg. an order of dismissal of this Court, cert. denied 444 U.S. 1015 (1980), where the Court stated, "Both administrative convenience and the likelihood that a petition never received was never sent support the rationale of [section 7502]." In Deutsch the Court barred the taxpayer from proving that he mailed the petition in any way other than as provided by section 7502.

[7] See Bloch v. Commissioner, 254 F.2d 277, 279 (9th Cir. 1958), where the Court indicated that since the enactment of sec. 7502, "There are no presumptions which we can indulge in appellant's [taxpayer's] behalf * * *."

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objective standards of section 7502 thus enabling them to establish prima facie evidence of delivery, respondent's motion to dismiss will be granted.[8]

As stated by this Court in Foerster v. Commissioner, T.C. Memo. 1981-32, "[W]e are not unmindful that the seeming inequities to the taxpayer would not exist had the alternative procedure provided by section 7502(c)(1) of mailing the petition by registered mail been followed." On the basis of this record, we conclude that we lack jurisdiction over this case.[9]

An appropriate order of dismissal for lack of jurisdiction will be entered.

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[8] Petitioners reliance on our opinion in Sylvan v. Commissioner, 65 T.C. 548 (1975), is misplaced. In Sylvan there was documentary evidence that the petition was mailed since it arrived in the Court's mailroom via U.S. mail, albeit on the 91st day. Thus, the Court could determine by objective proof that the cover was properly addressed and the postage prepaid. Similarly, in Curry v. Commissioner, 571 F.2d 1306 (4th Cir. 1978), revg. and remanding an order of dismissal of this Court, the Court had before it objective evidence that the petition was properly mailed since the petition and envelope in which it was contained were before the Court.

[9] See and compare Miller v. United States, ___ F.2d ____ (6th Cir., Mar. 3, 1986, 86-1 USTC par. 9261), affg. an unreported District Court's order. In Miller the court considered sec. 7502(c)(1) and affirmed the lower court's dismissal for lack of subject matter jurisdiction because plaintiff's claim for refund was never received by the Internal Revenue Service and it was not sent by registered mail.

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742 B JV 11.7/2: 1986-136

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ORIGINAL

T. C. Memo. 1986-136

UNITED STATES TAX COURT

KOH-I-NOOR RAPIDOGRAPH, INC., Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 24194-82. Filed April 7, 1986.

Norman A. Peil, Jr. and Joseph C. Hollywood, for the petitioner.

Richard J. Sapinski and Robert A. Stern, for the respondent.

MEMORANDUM OPINION

KORNER, Judge: Respondent determined deficiencies of income tax against petitioner for its calendar years 1978 and 1979 in the respective amounts of $13,970.50 and $15,694.70. After concessions, the issues which remain for us to decide are: (a) Whether petitioner is entitled to deduct certain amounts paid to or for the benefit of petitioner's then president, Paul B. Gloe, as travel and entertainment expenses, as claimed by petitioner in

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its returns for the years in question, or (b) alternatively, whether petitioner is entitled to deduct any of such amounts as additional compensation to Mr. Gloe.

Many of the facts herein were stipulated, and such stipulations, together with attached joint exhibits, are incorporated herein by this reference.

Petitioner is a New Jersey corporation which, at the time of filing the petition herein, had its principal place of business in Bloomsbury, New Jersey. Its corporate income tax returns for the calendar years 1978 and 1979 were timely filed with respondent, whose statutory notice of deficiency herein was sent to petitioner on July 30, 1982.

On October 1, 1974, petitioner employed Paul B. Gloe as General Manager. At some undisclosed time subsequent thereto, Gloe became President and Chief Executive Officer of petitioner, as well as a director, and so served throughout the year 1978 and until October 1, 1979. On the latter date, Mr. Gloe resigned as Chief Executive Officer and as a director of petitioner, but continued as President (without any duties) until December 31, 1979, at which point he resigned as President. During the years 1978 and 1979, petitioner paid Mr. Gloe compensation as an employee in the respective amounts of $193,238 and $248,071. At no time was Mr. Gloe a stockholder of petitioner, nor did he have any form of ownership interest in petitioner.

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As part of the terms of Mr. Gloe's employment by petitioner, it was agreed that

> The Employee [Gloe] is authorized to incur reasonable expenses for promoting the business of the Employer [petitioner], including expenses for entertainment, travel and similar items. The Employer will reimburse the Employee for all such expenses upon presentation by the Employee, from time to time, of an itemized account of such expenditures.

Pursuant to the above arrangement, petitioner furnished to Mr. Gloe one or more credit cards, and paid all charges incurred thereon by Mr. Gloe. Additionally, petitioner reimbursed Mr. Gloe for various other items of out-of-pocket expense which he incurred from time to time, and based upon expense vouchers presented by Mr. Gloe to petitioner. Under office procedures established by petitioner, all employee expense vouchers and accounts presented to petitioner for reimbursement were audited by an official of the company (other than the claimant) and were further rechecked for accuracy by another official before being approved for payment to the employee. Such procedures were followed in the case of the credit card charges and reimbursement claims submitted to petitioner by Mr. Gloe until sometime in early 1978. At that time, petitioner's treasurer, who had been auditing and approving Mr. Gloe's expense accounts, became dissatisfied with the nature of the expenses which were being incurred by Mr. Gloe and refused to approve his expense accounts. Other corporate officers likewise later refused to approve the

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credit card charges and expense reimbursement vouchers submitted by Mr. Gloe. As President and Chief Executive Officer of petitioner, however, Mr. Gloe had considerable power and autonomy. As a result, Mr. Gloe, beginning sometime in 1978, simply began approving his own expense accounts and causing petitioner to pay them. Increasing dissatisfaction with the nature and amount of Mr. Gloe's expenditures was apparently one of the factors leading to the termination of Mr. Gloe's employment with petitioner in the fall of 1979.

As part of the termination agreement between petitioner and Mr. Gloe, pursuant to which the latter resigned as Chief Executive Office and Director, effective October 1, 1979, and as President, effective December 31, 1979, it was agreed that if the Internal Revenue Service should audit petitioner's income tax returns for any of the years 1976 through 1979, and should disallow any of petitioner's claimed deductions as being nondeductible personal expenses of Mr. Gloe, the latter would reimburse petitioner to the extent of three-quarters of such disallowed amounts. In order to secure this promise, it was agreed that petitioner would withhold one-half, or $40,000, of the agreed termination payment of $80,000 to Mr. Gloe until the three-year statute of limitations had run on petitioner's 1979 tax year, or until conclusion of audit by the Internal Revenue Service, whichever should first occur.

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In its corporate income tax returns for 1978 and 1979, petitioner claimed deductions of $631,603 and $775,403, respectively, as travel and entertainment expense. Upon audit of petitioner's returns for these years, respondent disallowed the claimed travel and entertainment expense deductions in the respective amounts of $29,106 for 1978 and $34,119 for 1979. The nature and amount of the disallowed items are as shown in the table below. All such items were paid by petitioner to or for the benefit of Mr. Gloe or members of his family, except as otherwise noted. The basis for respondent's disallowance was that the items in question had not been shown to be ordinary and necessary business expenses of petitioner, nor that petitioner had met the requirements of section 274 of the Internal Revenue Code[1/] with respect thereto.

1/ All statutory references are to the Internal Revenue Code of 1954, as in effect in the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure, except as otherwise noted.

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Travel and Entertainment Expense

Character of Items	Amounts Disallowed 1978	1979
a) Airplane fares for Mr. Gloe and/or other members of Mr. Gloe's family	$ 7,895.18	$ 241.00
b) Purchases of merchandise, jewelry, etc. from various retail stores	461.36	2,188.08
c) Hotel bills and restaurant meals in various locations	6,522.42[2]	2,754.33
d) Rental car expenses	394.39	
e) Expense of babysitters	759.00	
f) Dues, fees and charges at Northampton Country Club, Easton, PA.	7,150.00[3]	6,456.00[3]
g) Traffic violation fine of Mr. Gloe's son		63.00
h) Costs of private airplane charters from Catlin Aviation and Presidential Airways (disallowed portion only)		7,150.00[4]
i) Cost of private airplane charter from Avia Jet		3,633.56[5]
j) Trip expenses of Paul Gloe to Scandinavia, Marco Island, Fla., and Bermuda		7,929.00[4]
k) Disallowances not identified in this record	5,923.65	3,704.03
	$29,106.00	$34,119.00

2/ Of this amount, it was stipulated that only $1,747.62 pertained to Mr. and Mrs. Gloe, and that the balance of $1,294.20 pertained to a Mr. and Mrs. Wagner. Petitioner has conceded that all challenged travel and entertainment expenses relating to Mr. and Mrs. Wagner in 1978 and 1979 were properly disallowed. No other such items properly attributable to Mr. or Mrs. Wagner appear to be in issue, so far as this record discloses.

3/ The membership was a "family" membership, meaning that charges could be incurred by Mr. Gloe, Mrs. Gloe or their children. During 1978 and 1979, charges in the respective amounts of $572.03 and $803.99 were incurred at times when Mr. Gloe was out of the Easton, PA. area.

4/ These amounts have now been conceded by petitioner as not being allowable travel and entertainment expenses.

5/ The total expense was $4,360.18. Respondent now concedes that all but $166.25 of the disallowed portion is allowable, and petitioner concedes the latter amount as an unallowable personal expense.

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Both issues raised by petitioner herein require us to consider the application of section 162, which provides in relevant part as follows:

> **SEC. 162. TRADE OR BUSINESS EXPENSES.**
>
> (a) In General.--There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including --
>
> (1) a reasonable allowance for salaries or other compensation for personal services actually rendered;
>
> (2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business;
> * * * .

Since petitioner's arguments are made in the alternative, we consider them separately.

I. Deductibility as business expenses under section 162 and 274.

The travel and entertainment expenses of petitioner which are in issue herein are of the type which must be justified as "ordinary and necessary expenses" of petitioner within the meaning of section 162(a). Additionally, as the table set out above indicates, they are expenses of a type which petitioner must substantiate pursuant to the requirements of section 274 and respondent's regulations thereunder. See secs. 1.274-1 through

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1.274-5, Income Tax Regs. Acknowledging this, petitioner on brief has further conceded that with certain exceptions hereinafter discussed, petitioner has failed to meet the substantiation requirements of section 274 and respondent's regulations thereunder with respect to the items in issue herein. We accordingly confine our consideration to these remaining items, five in number.

(a) As part of item (a) in the table above, for the year 1978 respondent disallowed the sum of $1,683. The stipulated evidence shows that this amount was the cost of air fare for Mrs. Gloe in accompanying Mr. Gloe on a trip to Europe and to the Bahamas. Mr. Gloe accompanied her husband to Hamburg, Germany to attend the fiftieth anniversary celebration of a West German corporation which was one of petitioner's shareholders. The celebration began on November 16, 1978 and ended on November 18, 1978. Mr. and Mrs. Gloe departed from New York on November 12, 1978, arrived in Hamburg on November 13, 1978 and stayed until November 20, 1978. They then proceeded to London, England, spent one night and then departed to Miami where they transferred on another flight to Freeport, Bahamas, where they stayed at a hotel from November 21, 1978 to November 26, 1978. On the latter date they departed and returned to New York, being accompanied on the last leg of their trip by their sons. Mrs. Gloe was not an employee of petitioner during 1978 or 1979 nor, so far as this record discloses, at any other time.

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Petitioner contends that the nature and amount of the expenditure has been fully substantiated pursuant to section 274, and should be allowable. The trouble with petitioner's position is that even assuming, arguendo, that the necessary substantiation requirements of respondent's regulations were met with regard to the time and amount of the expenditure, see section 1.274-5, Income Tax Regs., it still remains that there has been no demonstration that Mrs. Gloe's presence on the trip served a bona fide business purpose of petitioner. Section 274 does not grant any deductions. Sec. 1.274-1, Income Tax Regs. It is a limitation on deductions "otherwise allowable under this chapter" section 274(a)(1), which in this case means section 162(a). No doubt it was a very nice trip for Mrs. Gloe, but there is no indication in this record that her presence on this trip was of any benefit to petitioner's business activities. See sec. 1.162-2(c), Income Tax Regs. We must accordingly sustain respondent's disallowance.

(b) As part of respondent's disallowance shown for the year 1978 under item (c) of the above table, respondent disallowed the amount of $1,840.61 attributable to lodging expense incurred at the Galleria Plaza Hotel, Houston, Texas. The expense was attributable to Mr. and Mrs. Gloe's attendance at the International Rapidographic Blueprint Association Convention held in that city from May 2, 1978 through May 7, 1978. The above facts were all stipulated and we accept them, but there is no

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evidence in this record to show what kind of an organization the International Rapidographic Blueprint Association was, nor what relation the affairs of this association had to do with petitioner's business. On this record, we cannot even tell what petitioner's business was.6/ Lacking any evidence as to the business purpose of this trip, we must sustain respondent's disallowance of the claimed travel expense.

(c) For the year 1978 and also as part of the disallowances included under (c) of the above table, respondent disallowed the amount of $310.99. This expense was attributable to lodging expenses incurred by Mr. and Mrs. Gloe at the MGM Grand Hotel, Las Vegas, Nevada, where Mr. and Mrs. Gloe attended the College Bookstore Show held in that city from April 16 to April 19, 1978. As in the case of the prior item, there is nothing in this record to show any business reason for Mr. and Mrs. Gloe to attend the College Bookstore Show on petitioner's behalf, so as to constitute an ordinary and necessary business under section 162(a), and accordingly respondent is sustained.

(d) As another part of respondent's disallowance included in item (c) of the above table for the year 1978, there was the amount of $3,041.82, attributable to lodging expenses incurred at

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6/ Petitioner claims that it was engaged in the manufacture of writing instruments and cosmetics, but the only support for this contention in this record are statements made in petitioner's tax returns for 1978 and 1979. Statements made in tax returns are not self-proving. The returns herein were stipulated into evidence simply as true copies of the returns filed by petitioner. The truth of their contents was not stipulated.

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the Hyatt Regency, San Francisco, California, between April 19 and April 25, 1978. Of this total amount, expenses attributable to Mr. and Mrs. Gloe's attendance totaled $1,747.62.7/ On this trip, Mr. and Mrs. Gloe attended the American Institute of Design and Drafting Show in San Francisco, California between April 19, 1978 and April 25, 1978. As in the case of the prior items, there is no showing of any business purpose or connection between petitioner and the show for either Mr. and Mrs. Gloe. Without more, we must sustain respondent's disallowance of the claimed traveling expense.

(e) For 1979, and as part of the disallowance under item (c) of the above table, respondent disallowed the amount of $1,596, incurred by Mr. Gloe for lodging at the Contemporary Resort Hotel, Walt Disney World, Lake Buena Vista, Florida on May 6 and 7, 1979. It was stipulated that the expense was incurred for attendance at International Rapidographic Association Convention. As in the case of the prior items, we have no information on the connection, if any, between petitioner and this association which would make attendance by Mr. Gloe thereat an ordinary and necessary business expense of petitioner under section 162. We accordingly sustain respondent, in disallowing the claimed travel expense.

7/ Petitioner has conceded the disallowance of the remaining amount of this item.

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II. Allowance of the claimed deductions under Section 162 as additional compensation to Paul Gloe.

Prior to trial of the instant case, petitioner was permitted to amend his petition to raise a new and alternative issue, viz, that if any portion of the claimed travel and entertainment expenses with respect to Mr. and Mrs. Gloe were disallowed by the Court, thus sustaining respondent's determination, such disallowed portion should nevertheless be allowed to petitioner under section 162(a) as additional compensation to Mr. Gloe. Petitioner, of course, had the burden of proof on this newly raised issue, just as he had on the first issue. Welch v. Helvering, 290 U.S. 111 (1933); Rule 142(a). Furthermore where, as here, a claimed deduction is at issue, the burden was upon petitioner not only to show error by respondent in his determination, but also to prove his entitlement to the deduction, including compliance with all applicable provisions of law. Estate of Jayne v. Commissioner, 61 T.C. 744 (1974).

In the present case, it is clearly established that the amounts in question were paid by petitioner to or for the benefit of Mr. Gloe. In contending that they should be allowed to petitioner as deductions for compensation to Mr. Gloe, however, petitioner took upon itself the burden of proving that petitioner intended to pay such amounts to Mr. Gloe as compensation, and that the amount thereof, taking into consideration the other compensation paid to Mr. Gloe in the years in question, was reasonable. Botany Worsted Mills v. United States, 278 U.S. 282

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(1929); Electric & Neon Inc. v. Commissioner, 56 T.C. 1324 (1971), affd. 496 F.2d 876 (5th Cir. 1974); Paula Construction Co. v. Commissioner, 58 T.C. 1055 (1972), affd. 474 F.2d 1345 (5th Cir. 1973); sec. 1.162-7(a), Income Tax Regs.

On both these essential points, there was a complete failure of proof by petitioner.

There is not a scrap of evidence in this record that petitioner intended the payments in question to be treated as anything other than reimbursement of expenses incurred on its behalf by Mr. Gloe, and they were so claimed in petitioner's tax returns as "travel and entertainment expenses." In fact, the evidence of record strongly negates any intention of petitioner that such amounts be considered as compensation to Mr. Gloe. When the parting of the ways took place between petitioner and Mr. Gloe, effective October 1, 1979, the termination agreement between them, which is in evidence, clearly provided that if any of the claimed travel and entertainment expenses with respect to Mr. Gloe were disallowed by respondent upon audit, Mr. Gloe would be obligated to refund three-quarters of such amounts to petitioner, and an escrow fund of $40,000 was established, from moneys otherwise payable to Mr. Gloe, to secure his promise in this regard. We think it is clear from this record that, in paying these amounts, petitioner did not consider them as additional compensation to Mr. Gloe.

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Furthermore, as we have found, petitioner paid compensation to Mr. Gloe in 1978 and 1979 in the respective amounts of $193,238 and $248,071, and apparently claimed deductions for the same which were not challenged by respondent. These amounts certainly appear to be generous compensation to Mr. Gloe, and it was thus necessary for petitioner to prove that the additional amounts in issue herein, when added to the compensation already paid, still resulted in a total compensation to Mr. Gloe in each of these years which was reasonable in amount. No evidence at all was offered on this point.

We thus reject petitioner's claim that the amounts in issue herein are allowable deductions to petitioner as additional compensation to Mr. Gloe. In a case whose facts were remarkably like the present case, so far as the corporate taxpayer is concerned, we said in Olson v. Commissioner, T.C. Memo. 1958-56:

> For completeness, we refer briefly to the contention that, to the extent we might otherwise disallow any part of the claimed travel, entertainment and automobile expenses as deductions by the corporation, we should allow such amounts as deductions for additional salaries or other compensation paid to the * * * corporate officers. This is obviously an afterthought. There is nothing in the record to show that any such additional compensation was intended or expected, and the record fails to support the view that any such amounts, when related to the substantial salaries * * * accrued to or received by each of the [corporate officers] were reasonable. * * * We, therefore, reject the contentions urged in this respect. * * *

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We have considered the other arguments raised herein by petitioner and find them to be without merit.

Decision will be entered under Rule 155.

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ORIGINAL

T. C. Memo. 1986-137

UNITED STATES TAX COURT

GERALD P. ADAIR, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 778-85. Filed April 7, 1986.

Michael W. Thom, for the petitioner.

David G. Hendricks, for the respondent.

MEMORANDUM OPINION

FEATHERSTON, Judge: Respondent's motion to dismiss for lack of jurisdiction was assigned to Special Trial Judge Joan Seitz Pate for hearing, consideration, and ruling thereon.[1] After a review of the record, we agree with and adopt her opinion which is set forth below.

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[1] This case was assigned pursuant to Delegation Order No. 8 of this Court, 81 T.C. XXV (1983).

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PATE, Special Trial Judge: Respondent determined a deficiency in petitioner's 1979 Federal income tax of $85,146.37 and additions to tax under sections 6651(a)(1) and 6653(a)(1) of $13,684.20 and $4,257.32, respectively.[2] Respondent has moved to dismiss for lack of jurisdiction on the grounds that the petition was not filed within the time prescribed by law. Petitioner has also moved to dismiss for lack of jurisdiction alleging that respondent failed to properly mail or deliver the notice of deficiency thereby rendering it invalid. In addition, he asks that we determine that the statute of limitations expired prior to the time petitioner received actual notice. Alternatively, petitioner asks us to extend the time for filing a petition with this Court to 90 days after the date the petitioner actually received the notice of the deficiency. A ruling in favor of petitioner on this argument would result in our having jurisdiction to determine this case on its merits.

Petitioner, Gerald P. Adair, was a resident of Oklahoma City, Oklahoma at the time his petition was filed. He was primarily engaged in the restaurant business. At all times relevant to this litigation, he maintained an office for Adair, Inc. at Northeast 63rd Street, Oklahoma City, Oklahoma 73111 (hereinafter "the 63rd Street address"). Petitioner used this address when he filed his 1979 income tax return, which

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2 All section references are to the Internal Revenue Code of 1954, as amended and in effect during the year in issue. All Rule references are to the Tax Court Rules of Practice and Procedure.

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respondent received on October 28, 1981. He has also used this address on all subsequent communications with respondent. The parties have stipulated that this was petitioner's "last known address."

Petitioner originally was contacted by respondent with regard to auditing his 1979 income tax return. He was requested to supply copies of his 1980 and 1981 income tax returns for a meeting between his accountant and respondent. When petitioner failed to provide copies of the returns, respondent ended the meeting.[3] Subsequently, petitioner received two "30-day letters", both dated July 14, 1983, one for his 1979 income tax return, and the other for his 1980 and 1981 income tax returns.

On March 19, 1984 respondent sent petitioner a notice of deficiency for 1979 by certified mail addressed to the 63rd Street address. Although this was petitioner's correct address, the Postal Service returned it to respondent on April 4, 1984 as "unclaimed." According to notations on the envelope, first and second notices of attempted delivery had been issued by the Postal Service on March 20, 1984 and March 28, 1984. Petitioner never received either of the notices of attempted delivery or the original notice of deficiency for 1979.

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[3] At trial, we deferred ruling on the relevancy of a letter from petitioner's accountant to petitioner's attorney regarding respondent's audit of the income tax returns. We now rule that this letter is irrelevant to the issue in this proceeding, and, therefore, is inadmissible. Fed. R. Evid. 402.

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On July 31, 1984, respondent sent petitioner by certified mail a notice of deficiency for 1980 and 1981 which petitioner did receive in the normal course of mail delivery. Although petitioner felt uneasy about receiving a deficiency notice for 1980 and 1981 but not 1979, he did not make any inquiries of respondent.[4]

On August 27, 1984, respondent sent petitioner a statement reflecting the deficiency assessment for 1979. After questioning this statement, petitioner received a letter from respondent dated November 7, 1984 with which respondent included a copy of the deficiency notice. This was the first time that petitioner saw the 1979 notice of deficiency. On January 10, 1985, a petition was filed with this Court contesting respondent's determination for 1979.

Petitioner contends that he failed to receive the notice of deficiency because the Postal Service did not properly handle the letter. Mail addressed to the 63rd Street address is delivered to a mail box located approximately one block from the office maintained by petitioner. An employee regularly picks up the mail at the box and when a notification of attempted delivery of certified mail is received, the letter is picked up at the post office the following day. The employee who handled the mail during March 1984 testified that she did not remember receiving

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4 A separate petition has been filed contesting respondent's determinations for 1980 and 1981 and those years are not at issue in this case.

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any certified mail notices on either March 20 or March 28, 1984. During this period of time, neither petitioner nor any of Adair, Inc.'s employees refused delivery of any type of mail.

Petitioner alleges that the evidence shows that the Postal Service mishandled the letter. Therefore, he argues that the notice of deficiency is not valid because it was not properly "mailed" as required by the statute. Respondent contends that the notice of deficiency was properly mailed to petitioner's last known address, that it is valid regardless of actual receipt, and that, since the petition was not filed within 90 days of that mailing, this Court does not have jurisdiction to hear this case.[5]

It is well settled that both a valid notice of deficiency and a timely filed petition are necessary to maintain an action in this Court. Secs. 6212 and 6213; e.g., Pyo v. Commissioner, 83 T.C. 626, 632 (1984); Mollet v. Commissioner, 82 T.C. 618, 623 (1984), affd. without published opinion 757 F.2d 286 (11th Cir. 1985); Keeton v. Commissioner, 74 T.C. 377, 379 (1980). A valid notice of deficiency has been issued if it was mailed to the taxpayer's last known address by certified or registered mail. Sec. 6212(a) and (b)(1); sec. 301.6212-1(a) and (b), Proced. &

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5 This Court has jurisdiction to determine whether we have jurisdiction. Pyo v. Commissioner, 83 T.C. 626, 632 (1984); Brannon's of Shawnee, Inc. v. Commissioner, 69 T.C. 999, 1002 (1978).

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Admin. Regs. Since the parties have stipulated that respondent sent the notice of deficiency to petitioner's last known address, we need only determine whether it was properly "mailed."

To constitute a sufficient mailing, the notice must have been duly deposited with the Postal Service, and sent by certified or registered mail. Sec. 6212(a); Cataldo v. Commissioner, 60 T.C. 522, 524 (1973), affd. per curiam 499 F.2d 550 (2d Cir. 1974). Respondent fulfilled all of these requirements.

Nonetheless, petitioner argues that the notice of deficiency was not properly "mailed" because he did not receive it due to Postal Service mishandling, citing Estate of McKaig v. Commissioner, 51 T.C. 331 (1968), in support of his argument. In that case we held that although the deficiency notice as initially mailed may have been proper, the mailing was not completed because the notice had been diverted by the Postal Service and respondent knew or had reason to know of it. However, respondent maintains that in the instant case the documentary evidence shows that the Postal Service properly handled the 1979 notice of deficiency and, therefore, petitioner's failure to receive the letter must have been the fault of Adair, Inc.'s employees.

We have reviewed the record carefully and find that neither party has proved what happened to the letter. The evidence simply does not show whether the fault for the letter's not reaching petitioner lies with the employees of the Postal

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Service, Adair, Inc., some unknown third party or a combination thereof. Moreover, at this late date, we doubt whether either party could ascertain with any certainty just what happened to the letter. Therefore, we are faced with the issue of whether a valid notice of deficiency has been issued when the respondent delivers to the Postal Service a properly addressed notice and when petitioner does not receive the letter and does not have any actual knowledge of the deficiency prior to the expiration of the 90 day filing period.

Congress enacted section 6212(b)(1) as a safe harbor to protect the Commissioner where actual notice is not given. Mulvania v. Commissioner, 81 T.C. 65, 68 (1983); Frieling v. Commissioner, 81 T.C. 42, 52 (1983). Thus, if respondent follows the procedure set forth in section 6212, without more, the notice of deficiency is valid even if the taxpayer never receives it. E.g., Berger v. Commissioner, 404 F.2d 668 (3d Cir. 1968), affg. 48 T.C. 848 (1967); DeWelles v. United States, 378 F.2d 37, 39 (9th Cir. 1967), cert. denied 389 U.S. 996 (1967); Brown v. Lethert, 360 F.2d 560, 562 (8th Cir. 1966); Frieling v. Commissioner, supra at 52; Lifter v. Commissioner, 59 T.C. 818, 820-821 (1973).

We have carefully examined the cases cited by both parties and find that the facts in Lewin v. Commissioner, T.C. Memo. 1976-355, affd. per curiam 569 F.2d 444 (7th Cir. 1978), cert.

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denied 437 U.S. 904 (1978), are similar to the facts in this case. In evaluating those facts, the Seventh Circuit reasoned that--

> we can find no evidence of diversion from proper mailing procedure in this instance. * * * To assert that respondent, having once properly mailed notice to the taxpayer, has a further duty of providing actual notice before expiration of the 90-day statutory period is clearly contrary to the statute and prior decisions of this Court. * * * [569 F.2d at 447-448.]

Lewin is distinguishable, however, because the Court of Appeals found that "[p]roper mailing was effected and would have been completed but for petitioners' failure to claim the letter at the post office." 569 F.2d at 447. We do not so find in this case. As stated earlier, the evidence simply does not establish why petitioner did not receive the letter. However, as we noted in Zenco Engineering Corp. v. Commissioner, 75 T.C. 318, 323 (1980), affd. without published opinion 673 F.2d 1332 (7th Cir. 1981)--

> There is a strong presumption in the law that a properly addressed letter will be delivered, or offered for delivery, to the addressee. United States v. Ahrens, [530 F.2d 781 (8th Cir. 1976)]; Cataldo v. Commissioner, supra; August v. Commissioner, [54 T.C. 1535 (1970)]. Any other rule would impose unwarranted requirements upon respondent and would render meaningless the plain language of section 6212(b)(1) * * *.

Since petitioner failed to overcome this presumption, we find that respondent mailed a valid notice of deficiency to petitioner on March 19, 1984, after which petitioner had 90 days

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to file his petition with this Court. Since the petition herein was not filed until January 10, 1985, it was not timely, and respondent's motion to dismiss for lack of jurisdiction under section 6213(a) must be granted. Shipley v. Commissioner, 572 F.2d 212 (9th Cir. 1977), affg. a Memorandum Opinion of this Court.

Having sustained respondent's motion to dismiss for lack of jurisdiction, we cannot consider petitioner's "statute of limitations" argument. This is an affirmative defense to the determined deficiency which we could decide only if we had jurisdiction. Rule 39; see Frieling v. Commissioner, supra.

Further, this Court has no authority to grant petitioner's motion to extend the 90-day period for filing a petition, "whatever the equities of a particular case may be and regardless of the cause for its not being filed within the required time period." Axe v. Commissioner, 58 T.C. 256, 259 (1972). Petitioner is not, however, without adequate remedy or deprived of due process. He can pay the amount assessed, file a claim for refund and if the claim is denied, institute an action in the United States District Court or the United States Claims Court for recovery of any amount paid in excess of his lawful tax. Brown v. Lethert, supra at 562.

An appropriate order will be entered.

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